

# Shaping the Future of Social Protection:

Access,  
Financing and  
Solidarity



2 0 0 6



UNITED NATIONS

**ECLAC**

Thirty-first session of ECLAC  
Economic Commission for Latin America and the Caribbean (ECLAC)

Montevideo, Uruguay 20 - 24 March 2006



The symbols that appear on the cover of this book, “Nahua glyphs” and “Hands from Cañadón de las Cuevas”, form part of a series created in 1966 by Emilio Duhart, the architect who designed the headquarters of the Economic Commission for Latin America and the Caribbean (ECLAC) in Santiago, Chile. These symbols decorate the exterior walls of the building’s conference room. The third symbol is a 1995 sketch by Andrés Hannach of the headquarters’ emblematic spiral tower.



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The preparation of this document was coordinated by José Luis Machinea, Executive Secretary of ECLAC; Daniel Titelman, Coordinator of the Special Studies Unit, and Andras Uthoff, Officer-in-Charge of the Social Development Division.

Óscar Cetrángolo, Guillermo Cruces, Eduardo Fajnzylber and Martín Hopenhayn were involved in writing the individual chapters.

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Inputs and comments were also received from Eduardo Aldunate, Diane Alméras, Oscar Altimir, Irma Arriagada, Alicia Bárcena, Renato Baumann, Roberto Bisang, Ricardo Bitrán, Fabio Bertranou, Jorge Bravo, Marisa Bucheli, Inés Bustillo, James Cercone, Álvaro Corteza, Pedro Crocco, Rubens Cysne, Guilherme Delgado, Gustavo Demarco, Álvaro Erazo, Ernesto Espíndola, Natalia Ferreira-Coimbra, Rebeca Grynspan, José Miguel Guzmán, Edgar Herrera Zamora, Américo Ibarra, Dirk Jaspers, Juan Pablo Jiménez, Jorge Katz, Gabriel Lagomarsino, Eugenio Lahera, Arturo León, Hugo López, Flavia Marco, Juan Martín, Ricardo Martner, Marta Maurás, Andre Medici, Carmelo Mesa-Lago, Vivian Milosavljevic, Sonia Montaña, Carlos Mussi, Oliver Paddison, Joaquim Palme, Edward Palmer, Juan Carlos Ramírez, María Nieves Rico, Adolfo Rodríguez Herrera, Jorge Rodríguez, Rafael Rofman, Ianina Rossi, Mariana Schkolnik, Claudia Serrano, Ana Sojo, Rubén Suárez, Guillermo Sunkel, Víctor Tokman, André Urani, Álvaro Vásquez, Mario Velásquez, Helvia Velloso, Cecilia Vera, Pablo Villatoro, Jürgen Weller and Larry Willmore.

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## **Explanatory notes**

The following symbols are used in tables in this publication:

Three dots (...) indicate that data are not available or are not separately reported.

A minus sign (-) indicates a deficit or decrease, unless otherwise indicated.

A full stop (.) is used to indicate decimals.

Use of a hyphen (-) between years (e.g., 2001-2003) indicates reference to the complete period considered, including the beginning and end years.

The term “dollars” refers to United States dollars, unless otherwise specified.

Figures and percentages in tables may not necessarily add up to the corresponding totals due to rounding.



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## Foreword

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Since the early 1990s, ECLAC has been advocating a new development paradigm that is better suited to a globalized world of open economies. While retaining the Commission's long-standing focus on seeking out positive synergies between economic growth and social equity as part of a productive modernization process, this paradigm also underscores the importance of enhancing competitiveness, preserving macroeconomic balances and strengthening a participatory and inclusive democratic political system. The idea at the core of this proposal is that the Latin American and Caribbean economies will have to transform their production structures, as well as embarking upon an intensive process of human capital formation, in order to move their development process forward.

From a social perspective, ECLAC has placed special emphasis on promoting greater equality of opportunities through education and the benefits it brings to poor families, addressing and reversing the exclusionary dynamics of structurally heterogeneous labour markets, redistributing assets through social spending and promoting the full exercise of citizenship, with the ultimate aim being to strengthen democracy while laying the political foundations for the consolidation of more inclusive societies.

ECLAC now proposes to take this line of thought a step further by focusing on social protection. Today, the issue of social protection has reached a historic turning point at which the region is called upon to take a different approach in coping with the new global order and its implications for national societies. The main reason why solidarity-based social protection mechanisms need to be rethought is that the labour market has not demonstrated a capacity for greater inclusiveness either through the creation of decent job opportunities or in terms of the

level of social protection contributions. It is important, certainly, to promote policies to create more and better jobs, but in the short and medium terms, employment cannot be expected to serve as the sole mechanism for protecting the bulk of the population from the risks associated with a possible loss of income, health problems and ageing.

The structural changes reflected in the current situation call for a fresh approach to social protection within a framework of integral solidarity that combines contributory and non-contributory mechanisms. A new social covenant must therefore be formed in which social rights are seen as the normative horizon and existing inequalities and budgetary restrictions are the limiting factors to be addressed. In other words, the ethical imperatives that underpin a social rights-based covenant must be reconciled with existing financial constraints. Emphasis must also be placed on efficient resource use with a view to expanding the coverage and raising the quality of services, especially for the lowest-income sectors of the population.

The proposals put forward in this document are designed to build bridges between social rights and policy guidelines aimed at making them more enforceable through improved access, better financing and greater solidarity. To this end, the study devotes particular attention to some of the main issues relating to social protection, such as the reform and design of health and pension systems, taking into consideration both labour market dynamics and the countries' fiscal capacities. Programmes aimed at providing support to society's poorest groups are also examined. The analyses offered here are thus intended to delineate some of the issues that should be encompassed by a new social covenant founded upon the right to social protection.

**José Luis Machinea**  
Executive Secretary  
Economic Commission for Latin America  
and the Caribbean (ECLAC)



## Chapter I

# Rights-based development and a social protection covenant

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The challenge of universalizing and improving social protection has become a subject of political and academic debate, news headlines and soul-searching in Latin America and the Caribbean. Many people in the region are plagued by uncertainty regarding future employment, health care, social security coverage and household income.

It is therefore vital for the region's societies to agree on ways to combine rights-based development with the institutions and policies that will produce and allocate the resources needed to make those rights a reality. To accomplish this, social covenants will have to be forged between the various agents of the State and civil society within the framework of appropriate social institutions and authority to provide the necessary political strength and viability to move in that direction (Machinea, 2005a). These social pacts will also have to encompass fiscal covenants in order to ensure that the resources needed to implement such agreements will be available.<sup>1</sup> This set of conditions will permit a gradual expansion of social protection systems' accessibility, financing and solidarity components.

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<sup>1</sup> Fiscal and social covenants are not new concepts in ECLAC thinking. See the discussion concerning such a fiscal covenant formulated by ECLAC (1998 and 2000a) and, more specifically, the proposal regarding a covenant of social cohesion put forward in a substantive document presented at the thirtieth session of ECLAC (2004b).

The starting point for this study is therefore the principle that a rights-based approach should be used in framing public policy. The civil, political, economic, social and cultural rights enshrined in binding national and international agreements should form the normative framework for development. This calls for a social contract or covenant that would then be given political expression in both legislation and public policy. Democratic institutions provide the only means of creating such a covenant and ensuring it is established and implemented in accordance with legal principles. Democracy manifests itself through political agreements, and the fact that the region's countries embrace democratic values and ethics-based global accords and principles places social protection at the point where policy effectiveness and the normative power of social rights converge. Social protection is not simply something that society or governments achieve: it is an imperative which citizens have a right to demand.

This study therefore seeks to address the challenge of combining the ethical aspect of social rights with viable ways of strengthening citizens' entitlement to such rights in highly inequitable and relatively poor societies. It includes an exhaustive analysis of various aspects of social protection systems (health care, social security and poverty reduction) and their potential to guarantee social rights in structurally heterogeneous societies in the light of the need to build a social consensus regarding those rights and to have institutions that will act upon that consensus.

State institutions must be both technically and politically competent in order to provide citizens with the necessary legal and public policy mechanisms to demand their rights. It is also important for the universality of social rights to be internalized by all the various stakeholders in the spheres of employment, education and health, as well as by centralized and decentralized State authorities, so that day-to-day practice and policy decisions will all be geared towards a rights-based society. Until fairly recently, many Latin American countries were governed by authoritarian regimes that typically imposed harsh limitations on political and civil rights. Even in the more recent past, social rights have not always been fully applied or institutionalized, as will be discussed in greater depth in a later section of this document. In addition, the institutional context in which regional public policy has sought to promote rights has not been adapted to the variety of employment situations, living conditions and family structures that influence the social risk profiles of Latin American and Caribbean societies.

The effort to establish a social covenant must also, however, be accompanied by an assessment of existing financial constraints and of possible policy mechanisms for overcoming them. It is not only a matter of developing suitable technical approaches for optimizing the production and use of resources; it is also, in the final analysis, a political challenge involving the decisive yet delicate issue of the distribution of those resources. More egalitarian societies that are equipped with the necessary political and technical resources can boast greater achievements in terms of social protection and are therefore in a better position to make the concept of "social citizenship" (genuine and universal entitlement to social rights) a reality than societies with a similar level of development but a higher concentration of income and benefits. Furthermore, a better distributive structure not only facilitates the financing of more inclusive social protection systems, but also contributes to the design of suitable institutions and policies because it predisposes participants to seek common guidelines and agreements. The tax burden and structure, the expansion and selectivity of social spending and, to a certain extent, labour regulations are crucial yet controversial aspects of progress in the area of social protection based on an improved distribution of costs and benefits.

Nonetheless, providing access to social protection and financing its benefits also demand a rapid pace of economic growth, however. The array of possibilities open to individual countries depends on their level of development. It is therefore important for right-based development to mobilize society and the State by generating greater financial resources, and the additional resources aimed at generating economic growth must be used in a way that fits in with that vision of

development. This does not mean that the region's countries should wait until their GDP reaches industrialized-country levels before expanding social rights, but it is important to have an increasingly progressive resource base in order to ensure more and better access to the benefits, assets and services that will enable citizens to exercise their social rights more fully.

This document is based on the premise that achieving qualitative leaps forward in terms of the quality and coverage of social protection systems requires a political covenant or agreement as to the kind of society that we want. The dimensions of such a covenant are threefold. The first dimension is an ethical one, as this type of covenant must be governed by the principles enshrined in binding universal human rights accords, which assert that all people should have access to sufficient resources to provide them with a decent quality of life. The second dimension is a procedural one that involves the mechanisms needed to facilitate dialogue between social and political actors and to transform agreements into normative tools that can in turn be converted into policies. The third dimension has to do with the content of social protection, which should guide concrete actions in areas where people feel the most vulnerable, such as health, social security and a source of income to cover basic needs. In summary, the proposed covenant should translate people's rights into policies, mechanisms and benefits, define acceptable levels, progressivity indices and growth rates, and include agreements on how to apply the principle of solidarity through a variety of different mechanisms having redistributive implications. This document's aim is thus to provide substantive inputs for those agreements, on the understanding that political accords reached as part of democratic process make it possible to reorient development based on the universality of human rights.

A social protection covenant based on economic, social and cultural rights should include the three key elements that turn social policy into a tool for promoting equity: universality, solidarity and efficiency. As expressed by ECLAC, "...universality does not do away with the need to apply particular degrees of selectivity, and it cannot provide a basis for levels of protection for which financing is simply not available; the degree of solidarity must be compatible with the demands of social integration and with the structure of income distribution; and efficiency cannot be viewed solely in microeconomic terms, but must ultimately be understood as the capacity for maximizing social objectives within a context marked by the scarcity of resources" (ECLAC, 2000a, p.13).

This study explores ways of extending social rights to the whole of society in a region where most countries suffer from major structural inequalities, have high levels of poverty and attain moderate yet volatile levels of economic growth. This cannot be determined until we decide just how much inequality is ethically tolerable and whether or not there is a certain point after which this very inequality, rather than low average income, is what prevents us from making such rights (including social protection) universal and enforceable. This question is considered in the context of health (chapter III), social security (chapter IV) and poverty reduction programmes (chapter V). Chapter II examines the difficulties and challenges of extending contributory and non-contributory coverage, from the perspective of labour market dynamics and public finance. The cornerstones of this analysis and of the proposals that stem from it are income and equity thresholds, policy efficiency and effectiveness, and the institutional design needed to foster the necessary political support and implementation capacity for the application of such policies.

This first chapter sets out the general framework for the formulation of the specific sector-based proposals outlined in the other chapters. It is divided into three parts. The first explores the concept of rights-based development as such and provides background information. Within this context, human rights are regarded as a single, indivisible construct of civil, political, economic, social and cultural rights. Nonetheless, within that framework, special emphasis is placed on social rights, as they are the most significant category in the context of social protection systems. The

second section of this chapter examines barriers to the full exercise of social rights in the light of socio-economic and human development indicators. It also outlines the difficulties and trade-offs involved in attempting to reconcile the expansion of social rights with the constraints associated with the distribution and availability of resources. The third part places the debate in its historical and institutional context by relating it to the various models of the welfare State and their implications for social protection. In the course of this discussion, a social covenant entailing a procedural dimension, as well as substantive components, is advocated. Such a covenant is, as noted earlier, essential in order to lend support and viability to the policy reorientation required in order to couple the development process with full social rights and social protection systems based on the principles of universality and solidarity.

#### Box I.1

### ENFORCEABILITY OF ECONOMIC, SOCIAL AND CULTURAL RIGHTS

Although the body of international standards and agreements on human rights has been the starting point for entitlement to such rights, the latter has also been shaped by the way in which those standards have been transposed into constitutions and laws, which have in turn been translated into policies and practices that govern the democratic relationship between the State and civil society. The final step in this process comes when the entitlement to such rights eventually passes over from *de jure* to *de facto* status.

Robert Alexy (1993) proposes that four elements be considered in constructing modalities of justiciability. The first is whether or not the rights in question are subject to constitutional control. The second is whether or not the standards refer to objective duties (the general obligation of the State to provide suitable programmes) or subjective rights (an individual's right to demand access to a programme or benefit). The third is whether or not the rights are formulated as absolute rules (enabling each individual to demand that the State apply that standard or rule to him/her) or simply as principles (to be applied only where legally and factually possible). The fourth is whether the notion of social rights refers to a maximum or minimum level of well-being.

These variables can be combined to produce different forms of legal protection. At one extreme, the maximum level of protection for social rights would be attained when such rights are constitutionally protected, subjective, complete (i.e., rights to full coverage) and are backed up by a set of explicit rules. At the other extreme, social rights having a minimum degree of justiciability would be those that are not protected by the constitution, that are not subjective rights but instead give expression to objective duties of the State, that are structured in the form of principles and that are aimed at establishing a basic minimum (as opposed to maximum) level of well-being (Vicente de Roux and Ramírez, 2004, p. 20).

From the standpoint of global justice, States that have ratified the International Covenant on Economic, Social and Cultural Rights are bound to protect, respect and promote those rights. However, the potential financial implications of fully applying the rights contained in the Covenant have given rise to the concept of progressivity, which acknowledges that the process is a gradual one and compels States to guarantee the rights "to the maximum of its available resources", which leaves the necessary decision-making as to priorities and amounts open to the influence of political will and democratic processes.

In accordance with the concept of progressive obligation, all States parties, regardless of the extent of their national resources, are committed, from the very outset, to taking steps to enforce those rights as expeditiously as possible. Endowing such rights with a tangible form often involves passing legislative measures, which may or may not have to be supplemented with regulations, other legal and administrative measures, and political, economic and social decisions in order to ensure that they can be effectively exercised. Under international law, no interpretation is acceptable that permits States to defer the implementation of their obligations indefinitely (ECLAC, 2000a and ECLAC/IIDH, 1997).

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

## Development with rights and the right to development

### A human-rights-based approach to development <sup>2</sup>

The rights-based approach has been gaining more and more ground, not only as an ethical foundation for Latin American and Caribbean democracies, but also as a normative and programmatic framework for social development. The Universal Declaration of Human Rights adopted by the United Nations in 1948 establishes three types of rights which all form part of an indivisible whole. One of these categories, that of civil rights, refers to individual liberties and freedom from State coercion, and includes: the right to freedom of opinion and expression; the right to freedom of peaceful assembly and association; the right to freedom of thought, conscience and religion; the right to own property; and the right to justice. The category of political rights includes the right to take part in the government of one's country, directly or through freely chosen representatives, and the right to equal access to public service. The other category, that of economic, social and cultural rights (ESCR), includes the right to work, to free choice of employment, to social security, to just and favourable remuneration, to rest and leisure, the right to a standard of living adequate for health and well-being, to shelter and to participate in the cultural life of their community.

Social rights are increasingly invoked as a guiding principle for social policy, both among political actors and within international agencies, partly because social rights open the way to the incorporation of the principle of universality in the provision of social assistance and welfare services (Gordon, 2003). Unlike civil and political rights, the exercise of economic, social and cultural rights demands greater social progress and equality.<sup>3</sup> The recognition of these rights as genuine imperatives lends greater urgency and strength to the asset distribution mechanisms that facilitate progress towards less exclusive societies. Far from being a dichotomy between rights-based development and approaches that prioritize economic growth, this calls for an effort to find first-best solutions that provide for economic growth within a policy framework that promotes social citizenship while also contributing to political stability (through the mitigation of social differences), democracy (by linking it to a widespread increase in well-being) and human capital formation (thanks to broader access to education and health care).

Once economic, social and cultural rights have been established as inalienable rights ratified by governments, it is no longer possible to consider social citizenship as secondary to or contingent upon civil or political citizenship. The rights-based approach thus does away with the linear perspective by refuting the supposition that civil and political rights have to be guaranteed first, and that social rights can only be attended to once the former have been fully instituted.<sup>4</sup> In point of fact, a broad consensus exists as to the interdependence of respect for civil liberties, the exercise of political rights and people's access to goods, services and benefits that guarantee or promote well-being.

Inasmuch as respect for economic, social and cultural rights implies that it is the State's duty to promote greater integration in employment, education, information, knowledge, social safety nets and networks of social interaction, upholding those rights helps to strengthen citizens' capacity to participate in political institutions, public dialogue, civil associations and cultural exchange. By the same token, the greater the degree of equality in terms of the exercise of political rights and citizenship (in the republican sense of the word, i.e., citizens' involvement in public affairs), the greater will be the participation of excluded groups in decision-making processes that influence distributive policies and, hence, the greater the likelihood that political citizenship can be translated

<sup>2</sup> Previous ECLAC documents have sought to link the region's social and economic development with the framework afforded by human (particularly economic, social and cultural) rights. See ECLAC/IIDH (1997) and ECLAC (2000a).

<sup>3</sup> This document uses "ESCR" (economic, social and cultural rights) and "social rights" interchangeably, not because the two terms are synonymous, but because the issue of social protection is subsumed by ESCR as a whole and by social rights in particular.

<sup>4</sup> Having said this, it should nonetheless be remembered that the enforcement of social rights is a progressive process and will vary depending on the situation in the individual countries.

into social citizenship. The aim is therefore to develop links between the public voice, social empowerment, access to social protection benefits and the creation of opportunities through the development of human capital. Steps must be taken to reverse the asymmetry existing between those who make themselves heard by using their political and collective bargaining power to ensure their rights are protected and those who have less power and influence and who therefore find themselves unable to exercise those same rights. A social order based on social rights therefore needs to tip the balance of power and influence to avoid the vicious circle in which the most socially excluded are also the weakest in political terms.

Development guided by the normative framework of human rights tends to focus on the following aspects of living in society: productive development that goes hand in hand with the full exercise of individual liberties; a democratic order with truly representative mechanisms for settling disputes, applying policies and distributing power which encourages the involvement of the whole of society; distribution and service systems that, within the limitations imposed by the volume of resources produced, optimize the satisfaction of basic needs and the protection provided to the entire population; a labour market that respects the right to a decent income and operates as a genuine catalyst for social inclusion based on the mechanisms existing in other spheres of society; and full respect for cultural diversity and its manifestation in appropriate institutions so as to ensure that all individuals and groups have the right to be free of discrimination on the basis of cultural factors or affiliation and are free to live their lives according to their personal values while fully respecting the rights of others.

Applying a human-rights based approach to certain aspects of social protection brings us into the realm of enforceability, in which rights holders should be seen as citizens demanding their legitimate right to resources and services. This approach has identified a dynamic and progressive set of State obligations relating to economic, social and cultural rights, such as the right to an adequate standard of living, which presupposes the provision of universal social services and equal access to relevant goods and services.

### **Social rights and citizenship: concepts and trade-offs**

Development based on social citizenship must be founded upon a decision on the part of all members of society to live together as equals. This does not mean that all members of society must have the same lifestyle and way of thinking, but it does require an inclusive institutional structure that guarantees everyone the same opportunities to enjoy the benefits of community life and take part in the decisions that govern it. In this sense, poverty is not simply a socio-economic condition characterized by a lack of access to minimum basic necessities and of a share in collective progress due to the gap existing between the income of the poor and the average income in that society; the position of being poor or excluded is, above all, a lack of citizenship or of the preconditions for citizenship associated with the denial of social rights and the right to participate.

In this context, being socially protected is the consequence of a basic right to belong to society, the right to participation and inclusion. Based on this fundamental notion of belonging, citizens' rights are understood as the ability to enjoy a standard of living that is in keeping with the average levels of progress and well-being within a society. Social citizenship, in the sense of belonging to a community, means that deliberate State action can be taken to rein in the economic inequalities that, beyond a certain point, prevent many members of society from truly belonging to it.

Because the enjoyment of economic, social and cultural rights requires public capacity, institutions and resources, it takes time to increase the enforceability of such rights, and their extent of enforceability will inevitably vary from one society to another. Enforcement also requires a system for improving those institutions, extending the provision of resources and assets, and

making progress in processing social demands. A social covenant built on economic, social and cultural rights endows society with a horizon that provides it with a sense of direction. This type of social covenant should also help to determine exactly what forms such social rights should take, i.e., the range of benefits and assets for which all citizens are eligible and the time frame that society sets itself for making the full enjoyment of those rights a reality.

However, the fact that rights are implemented gradually does not make them any less obligatory; hence the need for institutional procedures that can serve as a basis for political and policy action aimed at making social rights truly universal. This sphere of institutional action encompasses major ethical and political questions. Who decides (and how) which benefits fully meet the social right to health and education in dynamic societies where a population's health status changes as its demographic and epidemiological profiles evolve, while education is raising the minimum requirements needed to increase a person's chances of being able to take part in production activity? And how are we to guarantee the right to work in an information economy that is downsizing its workforce, a volatile economy that contracts and expands rapidly, or an economy that has reached a turning point in its history where the relationship between higher productivity and increased employment is far from clear?

In addition, the quantity and quality of the social benefits that make these rights a reality depend on the availability of financial and economic resources generated by the market and on whether public institutions perform their oversight functions effectively enough to capture some of those resources, optimize their use in the realization of social rights in areas where they are in shortest supply, and build a consensus for those resources' redistribution between economically active and non-economically active members of society or between the rich and the poor. Furthermore, transfers do not take place only between the rich and the poor, but also between the poor and middle-income groups, or between one group of poor people and another. When limited resources mean that transfers can only be made to one group (such as poor children), another vulnerable group (such as older adults or ethnic minorities) is implicitly excluded from a potential benefit.

In addition, it is unclear how the concept of enforceability can be applied to quality standards and achievements, especially in the case of social programmes whose results are only seen over the long term and in situations where the levels regarded as being appropriate thresholds for the fulfilment of each need change over time. A century ago, for instance, an illiteracy rate of less than 30% and a coverage rate for basic education of 80% were considered a success, whereas today the right to education is usually measured in terms of full preschool coverage, a secondary-school completion rate of at least 75% and the eradication of illiteracy.<sup>5</sup> A life expectancy of 65 years may have been an optimum expression of the right to life in 1960, but it would not be considered so today.

According to Gordon (2003), a formal distinction should be drawn between social rights, which can be guaranteed because people have the option of initiating legal proceedings in order to demand them, and the social services supplied by a political system in response to a systemic demand for social integration, political legitimation and public order (Gordon, 2003, p. 11). The first notion is limited to rights in their legal context, whereas the second concept defines the scope of social policy and is the main focus of this document.

By the same token, a distinction should also be drawn between the individual demands of rights holders as such and the collective minimum levels that are set using a criterion of progressivity in keeping with the State's capacity to offer the benefits in question. These two types of considerations are not only different, but may actually clash in some cases. Conflicts may also

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<sup>5</sup> The Heads of State gathered at the second Summit of the Americas (Santiago, Chile, April 1998), adopted a plan of action that set out those goals in the area of education to be achieved by 2010. Other indicators include repetition and dropout rates (or, inversely, average progression rates) and effective learning thresholds, which all refer more to the quality of education than to coverage.

arise between the enforcement of an individual's social rights and the expansion of those rights' coverage. This sets up a dichotomy whereby the more intensive the enforcement of given individuals' rights is, the greater the extent to which the effective universality of those particular rights may have to be sacrificed (Vicente de Roux and Ramírez, 2004, p. 40). This is especially the case when resources are scarce, but it also holds true when changes are made in the public-private mix of service delivery components and when social protection services are redefined, thereby making it necessary to readjust the balance between the rights of the individual and the universality of social rights.

This final point will be analysed in greater detail in subsequent chapters. Selection criteria need to be applied to low-income groups in order to extend the effective enjoyment of rights to those who have been most deprived of them. In the case of universally recognized needs and rights, the State may give particular support to those who are not in a position to sustain themselves and whose voice is seldom heard in public discussions. Thus, far from running counter to the universal nature of social rights, selectivity and targeting —when used correctly— are redistributive instruments that can be employed to ensure, while taking into account the available resources, the exercise of a given social right for those who have been denied that right. This cannot, however, justify a policy under which the State would provide services and benefits to the poor alone, since such an approach would be in contradiction with the universal nature of social rights and would leave a wide section of middle-income groups in a vulnerable position and without funding for benefits in such areas as education and health.

Finally, combating inequalities based on ascriptive factors calls for the use of institutional affirmative action on behalf of disadvantaged groups. Expressed in extreme terms, this implies subordinating individual universal rights and the principle of equality before the law in favour of recognition for the specific rights and benefits of certain groups. The same argument used in the case of selectivity also applies here, inasmuch as allocating resources to the most vulnerable groups (or those most deprived of social citizenship) increases the total number of people exercising their entitlement to social rights. In order to remedy inequalities in the enjoyment of social rights, steps have to be taken to foster what might be referred to as “equality of life experiences”, as well as promoting equal opportunities. Selectivity and affirmative action can therefore have a positive influence both in terms of ensuring equal opportunities at the outset and in reducing inequality in terms of outcomes. Although equal opportunity is the defining principle of equity, people from different backgrounds in terms of origin, socialization, geographical location or identity may face greater or lesser obstacles in taking advantage of existing opportunities. Asymmetries in terms of information, quality of service, access to social networks, recognition and opportunity costs result in different life paths, even when equal opportunities are strengthened at the outset through measures such as universal access to basic education. Selectivity and affirmative action are therefore useful means of at least partially offsetting such asymmetries.

The exercise of economic, social and cultural rights calls for progress in the areas of social policy, tax structure, the targeting and scale of public social spending, the regulation of capital and labour, policies for promoting the formation and maintenance of human capital and the effects in terms of redistribution and increased opportunities, mitigation of social costs through the use of countercyclical policies to dampen economic volatility, efficiency in policy management in order to optimize the effects of programmes and policies that target disadvantaged groups, family welfare policies (including childcare and elder care) that facilitate women's entry into the labour market, limits on financial predation and speculation, and strong anti-discrimination policies designed to reverse inequalities based on ascriptive traits.

## Economic, social and cultural rights in Latin America: major shortfalls, major challenges

In terms of human rights policy and standards, the region's progress over the last 20 years in the promotion of civil and political rights has differed markedly from its rate of advance in the area of economic, social and cultural rights. In the case of civil and political rights, many countries in the region have been making rapid headway in institutionalizing democracy and restoring the rule of law. Today, virtually all the countries in the region have popularly elected leaders (presidents, members of parliament and mayors or governors). Freedom of thought, expression, religion and association is almost universal, although problems remain in terms of the workings of the legal system, corruption, a lack of effective participation in political debate and representation, and the persistence of discrimination on the basis of race, gender and place of origin. The most striking case, however, is the area of social protection, where corporate lobbies and interest groups bring pressure to bear in order to obtain sinecures or advantages over other groups and succeed in doing so because they wield more de facto power, have partisan links with the government or better networks of contacts. In most cases, the countries' governments are taking steps to rectify this situation, although the pace and intensity of those efforts differ considerably from country to country.

The region has not made the same sort of progress in the area of economic, social and cultural rights, at least in relation to poverty and income distribution. The region's societies and economies still exhibit structural factors of exclusion, such as segmentation based on people's roles within the production apparatus, ascriptive traits or geographical location, as well as markedly inequitable access to assets and property. All of these factors perpetuate and reinforce inequalities and prevent progress from having the types of distributive effects associated with economic, social and cultural rights.

Furthermore, progress in this direction is held back by new risks and constraints related to economic volatility, external vulnerability, changes in labour patterns and the growing role of power groups. Not only does this situation give rise to greater demands for social protection in the light of the countries' economic vulnerability, but it also erodes States' capacity to respond to their citizens' demands, thereby making social inclusion and protection even more difficult to achieve. Rigidities in income distribution, problems encountered in reducing the number of poor people, declining and increasingly precarious employment, and the procyclical nature of public finances all illustrate this state of affairs.

Economic volatility has a particularly negative social impact, as it hampers governments' efforts to expand social investment in the poorest groups. Over the past decade, this type of investment has nonetheless led to an expansion of social spending in almost all the region's countries and, in many, a reprioritization of public expenditure aimed at heightening its impact on the poorest groups. Be this as it may, efforts to address this problem have been thwarted by the relatively flat trend of per capita GDP between 1980 and 2003 (albeit with many variations in between those years), low investment, intractable poverty indices and the labour market's rising informality.

This is yet further proof that implementing social rights is a complex and difficult affair that is influenced by growth and economic policy. In fact, economic reforms can give rise to huge differences between the degree of access to the fruits of development enjoyed by "winners" and "losers", as well as having unpredictable consequences and differing short- and long-term effects. For instance, income transfers carried out as part of a social assistance programme will have short-term effects, whereas educational reform is a long-term measure. As pointed out in chapter V, the ideal scenario is one in which short-term assistance policies are merged with human capital formation in the longer term.

In line with the tradition of proposed changes in production patterns with social equity that has guided the work of ECLAC for many years, this study contends that strengthening social rights does not necessarily involve sacrificing economic growth (ECLAC, 1990; and ECLAC/UNESCO, 1992). Even advocates of viewpoints that differ from the ECLAC tradition are increasingly coming to recognize that greater equality of opportunity may complement and contribute to long-term growth, since sustained growth tends to be much more difficult to achieve in highly unequal societies. According to Bourguignon, Ferreira and Walton (2005), if significant parts of the population have restricted opportunities for investment and innovation, while those at the top have extensive opportunities to pursue their private interests, then there will be both efficiency losses and adverse dynamic effects. These authors describe “a negative relationship between inequity and economic processes affecting efficiency or growth in two areas: in the inefficient results from the interaction between market imperfections and inequalities of assets, status or influence; and in the effects of extreme political inequalities on the design of economic institutions, with a tendency to form institutions that promote predation, rent-seeking or protection of economic (and other) privileges, rather than broad-based incentives for investment and innovation” (Bourguignon, Ferreira and Walton, 2005, p. 2).

It is also the case, however, that the more influential societies in terms of the exercise of economic, social and cultural rights generate synergies in development dynamics and the legitimization of democracy. In the case of development, more widespread exercise of these rights leads to greater human capital formation thanks to universal access to good-quality education and health services. This increases the production structure’s capacity to leapfrog stages of technical progress, thereby boosting national economies to higher and higher levels of domestic and external competitiveness. As many as 15 years ago, ECLAC was already arguing that genuine competitiveness is based on more highly trained human resources and a greater incorporation of technical progress, which in the long run generates a more sustainable form of development that is better able to reconcile growth with social equity (ECLAC, 1990; and ECLAC/UNESCO, 1992). In the case of democracy, analyses based on opinion polls conducted in a majority of the Latin American countries indicate that their citizens regard the expansion of social rights as the most valuable source of legitimacy for their political democracies.<sup>6</sup> The expansion of such rights is believed to result in better governance and political stability, less social conflict and, thus, a more solid institutional foundation for investment and development.

## Social rights and inequalities

### Income distribution

The Latin American countries’ deeply unequal income distribution interferes with its citizens’ exercise of their social rights. These distributive inequalities are not confined to the region’s income gap, but also constitute both a cause and consequence of gaps in terms of social well-being, human capital, productive assets and the full exercise of citizens’ rights. Inequality and poverty, in particular, contravene the right to an adequate standard of living, whether measured in absolute (poverty line) or relative (comparing income strata) terms.

Although many countries in the region have reached a level of development that could enable a significant proportion of the poor to escape from poverty, 40.6% of Latin American households are currently below the poverty line and lack basic social protection. That percentage represents 213 million people, 88 million of whom are living in extreme poverty (ECLAC, 2005a, figures projected to 2005). Because the region’s societies are so inequitable, poverty levels remain exceedingly high even though the countries’ per capita income levels may be equated with mid-range stages of development. The fact that many people are unable to access a basic set of satisfiers

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<sup>6</sup> See UNDP (2004a). The conclusion reached by this report is unequivocal: any loss of legitimacy for democracy is mainly due to a failure to disseminate social rights, i.e., people’s perception that democracy does not guarantee access to employment, sufficient income, greater social equality or less poverty.

is a concern for the whole of society and a dramatic demonstration of the negative implications that unequal income distribution has for the exercise of social rights.

Lack of equity is a problem that has long afflicted the region's societies and is the result of a combination of highly segmented economic, social, gender and ethnic structures (Machinea and Hopenhayn, 2005). The most striking manifestation of this lack of equity is the inequality of income distribution, which is both the cause and effect of inequalities in other areas, such as education and employment. In fact, the distribution of per capita household income faithfully mirrors the unequal distribution of education, knowledge, capital, employment opportunities and financing. Access to such assets is contingent upon the ability to pay for quality education and health services, as well as for entry into segmented labour and credit markets. This generates a vicious circle of poverty, as young people from poor households have less access to the markets and assets that would enable them to escape from poverty.

The violation of rights as a result of such inequalities is even more dramatic when it infringes upon individuals' chances of survival during the first few years of life. The ethical unacceptability of inequality in income distribution is underscored by the fact that the region produces enough food to feed its population three times over. Yet there are nonetheless countries with high levels of undernutrition, overall malnutrition and acute malnutrition, especially among groups living in extreme poverty, ethnic minorities and the rural population.

Thus, assuming a constant level of per capita income, greater inequality in income distribution will be directly related to higher poverty indices. One of the main targets associated with the Millennium Development Goals of the United Nations is to halve extreme poverty by 2015. To meet this target, it is estimated that the region's poorest countries would have to achieve annual per capita GDP growth rates of close to 4.8% between 2006 and 2015. If, however, changes in distribution were to reduce the Gini coefficient of income inequality by 10%, the growth rate needed to reach the target would drop to an average of 2.8% per year (see figure I.1).

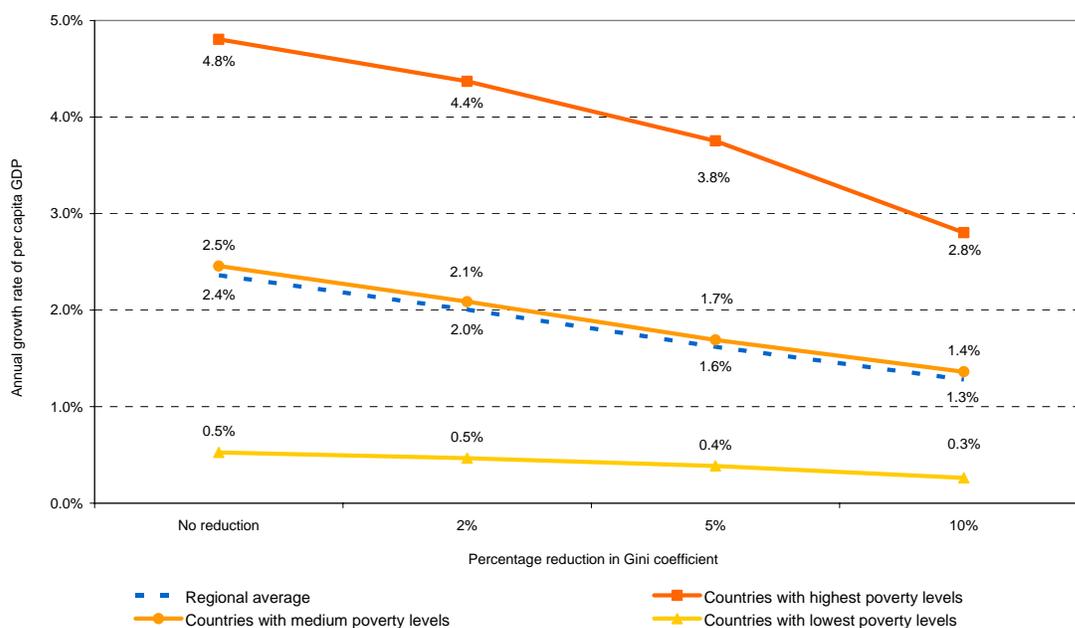
A comparison of the region's Gini index with those of the other world regions sheds light on the extent of inequality in Latin America's income distribution. The comparison shows that not only is the Latin American and Caribbean region the most unequal one in the world as measured by income distribution, but that the dispersion of inequality is also much higher than elsewhere (see figure I.2). This is a clear sign that, in addition to the shortage of financial resources, the lack of social protection in the region is also closely linked to the distribution structure that underlies the whole of society.

Other ECLAC studies that have looked at the ratio between the income of the richest decile and the poorest 40% of the population point to an even greater concentration of income. In 2002, the smallest differential between these two groups was recorded in Uruguay, where the top decile received 27.3% of national income, which was 9.5 times as much as the incomes of the bottom four deciles. At the other extreme, in 2001 the poorest 40% of the population in Brazil received only 10.2% of total income, while the richest decile obtained almost half (46.8%) (32.2 times more) (ECLAC, 2004a). On average, the richest decile receives 36.1% of household income in Latin America (ECLAC, 2004a). Furthermore, in most of the region's countries, the proportion received by the highest decile has tended to increase in the last decade, thereby reinforcing a historically regressive trend.<sup>7</sup>

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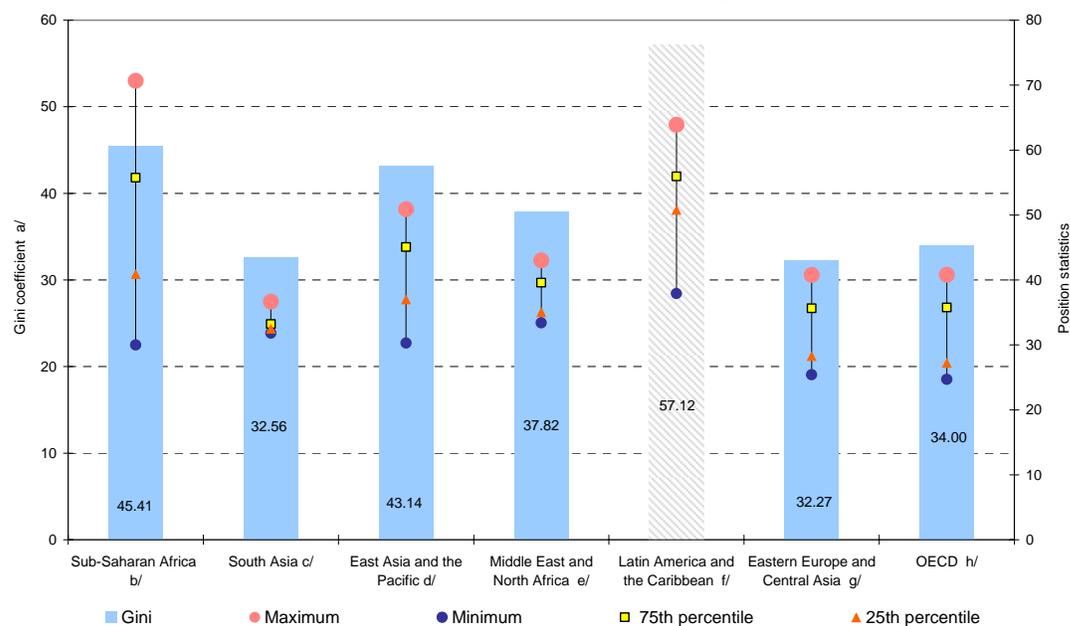
<sup>7</sup> The proportion of national income received by the richest 10% of the population provides a clear picture of distributive inequalities, since this high concentration in the top decile is one of the main reasons why the region has the most regressive income distribution in the world.

Figure I.1  
**LATIN AMERICA: PER CAPITA GROWTH RATES REQUIRED IN 2006-2015, UNDER DIFFERENT SCENARIOS OF DISTRIBUTIVE CHANGES, TO HALVE EXTREME POVERTY**



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of projections prepared using data from household surveys conducted in the relevant countries.

Figure I.2  
**LATIN AMERICA AND THE CARIBBEAN: THE MOST UNEQUAL REGION IN THE WORLD**



Source: World Bank, *World Development Indicators* [online] and Economic Commission for Latin America and the Caribbean (ECLAC).

<sup>a</sup> Regional average, weighted by each country's population as a share of the corresponding regional total. The most recent Gini coefficient available from the period 1985-2004 was used for each country. <sup>b</sup> 30 countries. <sup>c</sup> 5 countries. <sup>d</sup> 12 countries. <sup>e</sup> 8 countries. <sup>f</sup> 20 countries. <sup>g</sup> 27 countries. <sup>h</sup> 22 countries.

## The blurred link between education and employment<sup>8</sup>

As part of the region's efforts to reduce inequality as a means of providing greater social protection, consideration should be given to the employment options available to students. The link between a more advanced education and more and better employment options for young people seems to hold true only for a minority of high achievers. Paradoxically, today's young men and women have more years of formal schooling than previous generations, yet they also have unemployment rates that are two or three times higher than their predecessors'. Current generations of young people are more integrated into knowledge acquisition and human capital formation processes, but have less access to the labour market and sources of livelihood where they could put that human capital to use. This is partly because the present stage of technical progress is such that more years of education are required to qualify for the jobs of today. This situation can be viewed as the result of an "educational devaluation", whereby a given number of years of schooling is worth less than it was 20 years ago. Other factors include the greater job instability associated with new types of organizational patterns found in today's labour market, the fact that the majority of new jobs are being created in the informal sector, and new entrants' lack of acquired rights and work experience.

Education is usually considered to be the main means of reducing inequalities and overcoming the intergenerational reproduction of poverty, thanks to the virtuous circles formed by increased education, social and labour mobility, and higher income. The positive effects that higher educational attainment has on a student's future career path are well known. The persistence of gaps in terms of educational quality and achievement between differing income levels or geographical, ethnic or racial groups tends to perpetuate inequalities from one generation to the next, as well as among social groups, between urban and rural areas, and between ethnic minorities and the rest of the population. Viewed from this vantage point, the right to education is very much an ongoing issue.

In 18 countries of the region, at least one out of every four people between the ages of 15 and 19 in the poorest 20% of households have not completed their primary education, whereas the corresponding ratio for young people in the highest income quintile is only 1 out of 25. The poorest decile has a weighted average of 3.1 years of schooling, while the richest has a weighted average of 11.4 years. This has major implications for social equity, since parents' educational levels have a very strong influence in determining how much schooling their children will receive. On average, the children of a father who never went to school will accumulate three years of schooling, whereas, if the father has attended an institution of higher education, his children will complete 13 years of schooling (ECLAC/UNESCO, 2005).

Inequalities in terms of educational achievement are a cause and consequence of socio-economic inequalities. Limited educational attainment leads to the reproduction of poverty as part of a vicious circle that also interferes with the exercise of other rights. There are two sets of data which demonstrate that the incomplete exercise of the right to education affects the enjoyment of the right to life and effective entitlement to reproductive rights. The first set of data attests to the negative correlation between a mother's level of education and the child mortality rate. The second points up the inverse correlation between educational achievement and early motherhood. Indeed, teenage pregnancy is one of highest-risk factors for poverty and vulnerability, as it is often a harbinger of a future of single-parent families with poorly educated female heads of household who have little chance of producing sufficient income to lift those households out of extreme poverty.

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<sup>8</sup> This study does not include an in depth examination of education or employment issues but instead focuses on topics that are more specifically related to social protection, such as health, social security and assistance programmes for the poor. Chapter II does, however, provide an analysis of some aspects of labour demand and its consequences in terms of social protection. Chapter V indirectly addresses education coverage for poor boys and girls in the course of its discussion of conditional cash transfer programmes based on school attendance.

The quality and quantity of education that people need in order to obtain a job that ensures them a decent standard of living will increase in step with the overall society's average level of achievement. In the mid-1990s, ECLAC estimated that between 10 and 12 years of formal education were required in order for people to obtain employment that would prevent them from becoming poor or enable them to escape from poverty, although the figures did vary somewhat from country to country. In 2002, an average of 38.1% of the men and 45.6% of the women aged 15-29 who had from 10 to 12 years of education were working in low-productivity jobs (ECLAC/OIJ, 2004).

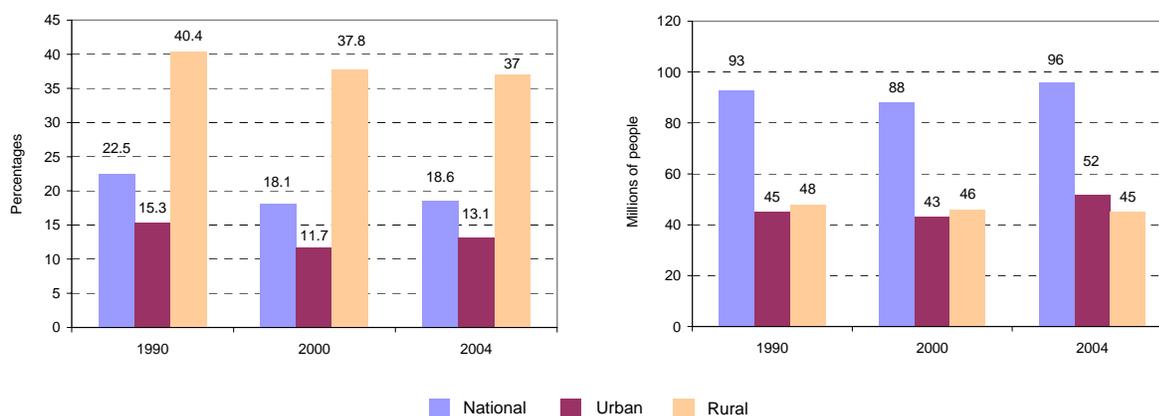
The social stratification produced or maintained by these segmented employment patterns combines with a global and regional tendency towards a widening gap between the incomes of professionals and technicians and formal-sector employees. Between 1990 and 1997, the average differential between these two groups increased by 24% in the region, while the income gap between the most highly qualified workers and employees of small and medium-sized enterprises (SMEs) expanded by 28% (ECLAC, 2000b). This also raises questions about future employment prospects for young people who are beginning or completing their secondary education but who do not go on to study in an institution of higher learning.

### Geographical and ascriptive factors

Groups whose identities are based on such ascriptive factors as geographical location, ethnicity, race or gender are more vulnerable to poverty and inequality. This violates not only the social right to a decent life, but also the cultural right to non-discrimination.

In terms of territorial distribution, poverty levels remain much higher in rural than in urban areas. In Latin America, 37% of the rural population is indigent, compared to just 13% in urban areas (see figure I.3). Largely because of the region's growing urbanization, however, since 2002 indigents living in urban areas outnumber their rural counterparts. According to estimates up to 2004, 52 million of the 96 million people living in extreme poverty in Latin America are located in urban areas.

Figure I.3  
**LATIN AMERICA: INDIGENCE RATES, BY GEOGRAPHICAL AREA, 1990-2004**<sup>a</sup>  
(Percentages and millions of people)<sup>b</sup>



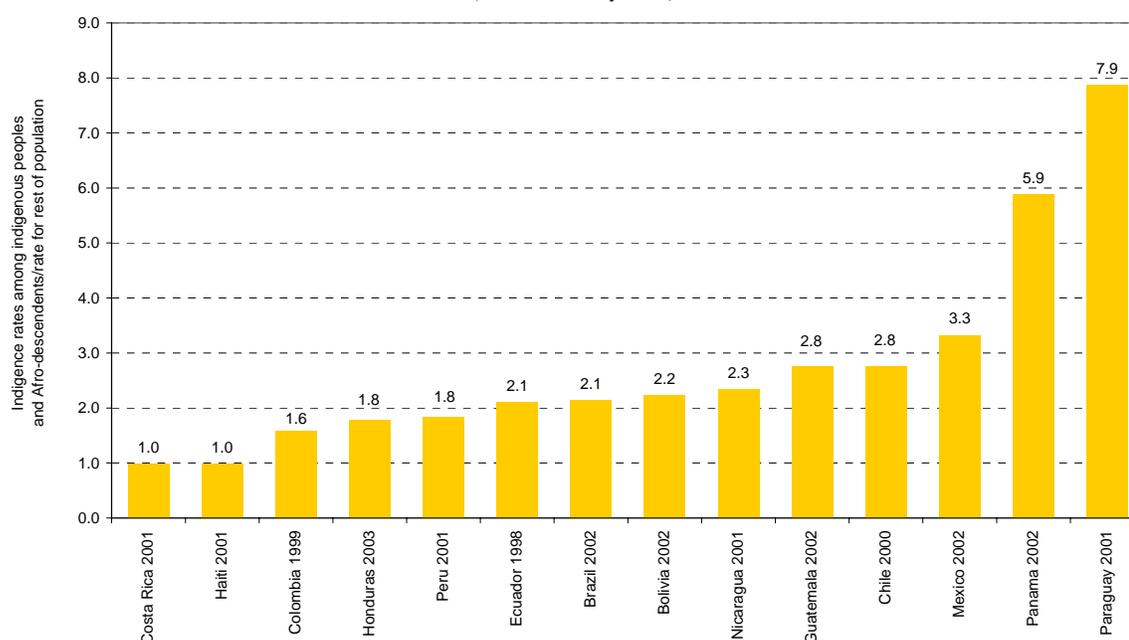
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of projections prepared using data from household surveys conducted in the relevant countries.

<sup>a</sup> Estimate for 19 countries.

<sup>b</sup> The figures for 2004 are projections.

In terms of groups associated with the ascription of ethnically- or racially-based traits, Latin America's indigenous peoples (who represent over 25% of the population in Bolivia, Ecuador, Guatemala and Peru) and Afro-descendants (who represent more than a quarter of the population in Brazil, Nicaragua and Panama) are, to a large extent, the poorest in the region, exhibit the worst socio-economic indicators and enjoy very limited cultural recognition and access to decision-making processes. As shown in figure I.4, indigence (i.e., extreme poverty) rates are between 1.6 times and 7.9 times higher (Colombia and Paraguay, respectively) among indigenous and Afro-descendant peoples than among the rest of the population (except in Costa Rica and Haiti, where membership in ethnic groups does not seem to be associated with any differences in indigence levels).

Figure I.4  
**LATIN AMERICA (14 COUNTRIES): INDIGENCE RATES AMONG INDIGENOUS PEOPLES  
 AND AFRO-DESCENDENTS AS A MULTIPLE OF THE RATE  
 FOR THE REST OF THE POPULATION**  
*(Dollar-a-day line)*



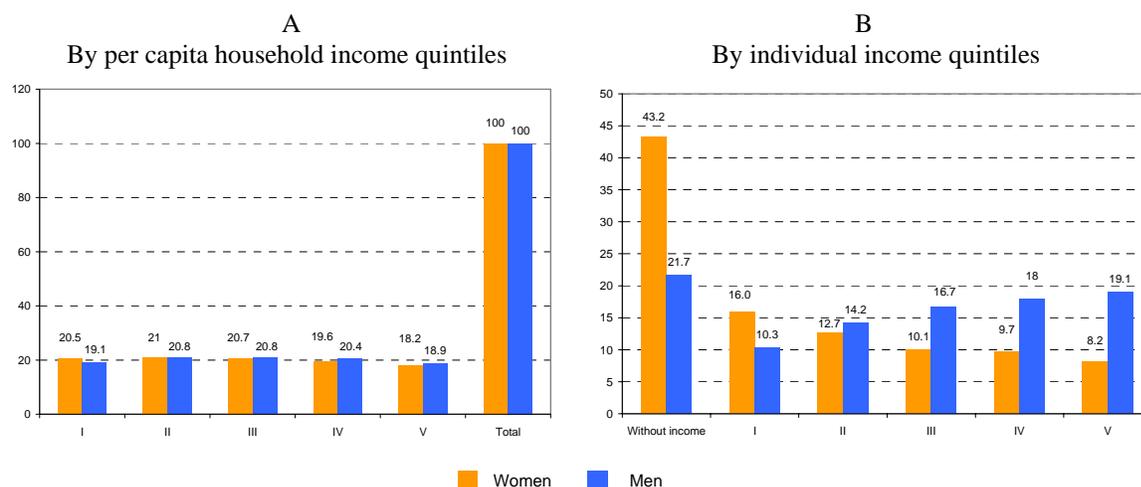
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from household surveys conducted in the relevant countries.

Gender-based inequalities in Latin America are well documented. They are chiefly manifested in degrees of access to the labour market and employment conditions, vulnerability in the home, and the exercise of citizenship and reproductive rights. In every one of these cases, these gender-based inequalities invariably work to the detriment of women. Indirectly, they also have a negative effect on social protection, since, in the region, access to benefits is closely linked to employment status.

Women outnumber men in poor Latin American households. This is especially true of working-age women (20-59 years), for whom the ratio of the number of women to men was 108 in poor households as compared to 96 in non-poor households.<sup>9</sup> Discrimination against women is even more noticeable when a distinction is made between per capita household income and individual income (see figure I.5).

<sup>9</sup> Estimates based on special tabulations from household surveys.

Figure I.5  
**DISTRIBUTION OF POPULATION 15 YEARS AND OLDER, BY SEX, IN PER CAPITA  
 AND INDIVIDUAL INCOME QUINTILES**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from household surveys conducted in the relevant countries.

Reversing such historically entrenched inequalities is no easy task, as they represent an accumulation of systemic disadvantages and forms of discrimination that are ingrained day-to-day practices. It should be pointed out, however, that most of the region's countries have made significant inroads during the last decade in rooting out both ethnic and gender discrimination. Headway has been made in the areas of political institutions, legislation and justice, as well as in formulating social policies that take ascriptive variables into account in order to improve their targeting of groups whose vulnerable or disadvantaged positions are associated with their members' gender or ethnic origin. Yet despite these efforts, a series of deeply rooted social differences condemns these groups to increased poverty and higher risks than other members of society. The transition from de jure to de facto rights is by no means immediate, and profound cultural change will be required if it is to be achieved.

### Nuanced considerations: rights, access and distribution

The failure to achieve greater equity in these areas stands in contrast to major achievements in other areas, the most important of which is the considerable increase in life expectancy attained in most of region's countries during recent decades. According to data compiled by ECLAC, average life expectancy in the region in 1970-1975 was 61.4 years, while by 2000-2005, it had risen to 72.0 years. In Brazil, for instance, life expectancy rose from 59.8 years in 1970-1975 to 71.0 years in 2000-2005. During the same period, life expectancy went from 46.7 to 63.8 years in Bolivia, from 55.5 to 69.0 years in Peru and from 68.1 to 78.1 years in Costa Rica.<sup>10</sup> These data are significant not only because they reflect an extension of the right to life, but also because life expectancy rises in step with improvements in other key indicators relating to economic, social and cultural rights, such as expanded access to health and education, better nutrition and availability of water and sanitation services. The relative ageing of the population, in turn, brings greater pressure to bear on the financing of pension and health systems (see chapters III and IV).

<sup>10</sup> Estimates and projections from the Latin American and Caribbean Demographic Centre (CELADE)-Population Division of ECLAC ([www.cepal.org/celade/proyecciones/basedatos\\_BD.htm](http://www.cepal.org/celade/proyecciones/basedatos_BD.htm)). Also see estimates and projections from the United Nations Population Division (<http://esa.un.org/unpp/index.asp>) and ECLAC (2004a).

Data from the above sources indicate that, in 1970-1975, the infant mortality rate was 80.8 per 1,000 live births (deaths of children under 1 year of age) and that, by 2000-2005, the rate had dropped to 27.4 per 1,000. Although the region reduced infant mortality more than any other (from 42.9% to 25.6% between 1990 and 2003 according to United Nations data), some countries have higher rates than the overall average rate for Asia (53.1%). In the first quintile, the rate in a few Latin American countries is even higher than overall average infant mortality rate for Africa (United Nations, 2005, pp. 138-142).

Other significant improvements in quality-of-life indicators over the past 40 or 50 years include lower illiteracy rates, higher (and gender-balanced) gross enrolment rates in primary and secondary education, greater access to drinking water and sanitation, and increased supply of durable goods in people's homes. Between 1960 and 2000, the number of inhabitants per doctor dropped from around 3,000 to 1,717 (simple average) or 1,307 (weighted average). Illiteracy among 15-year-olds fell from around 26.3% in 1970 to 9.5% in 2005.<sup>11</sup> The gross enrolment rate in the first level of education went from just over 77% of school-age children in 1970, to 96% in 2001, while the increase in secondary school enrolment rose from 21% in 1970 to 29% in 1990, and had jumped to 64% by 2001. Educational achievement levels are higher among girls than boys in both primary and secondary education.<sup>12</sup> Finally, the percentage of the population with access to drinking water climbed from 83% to 89% between 1990 and 2002, while the percentage of the population with access to sanitation services rose from 69% to 75% during the same period.<sup>13</sup> Here again, however, the expansion was not uniform, and in rural areas (especially in the poorer countries), access conditions are comparable to average levels in Africa, the world's poorest region. By way of example, in 2002 no more than 35% of the rural population had access to sanitation services in countries such as Peru, Haiti and Bolivia, with the rate just barely reached that level in Brazil (United Nations, 2005, p. 195).

Improvements in these indicators now situate the region, on average, well above other developing regions in terms of human development.<sup>14</sup> The fields in which these advances have taken place constitute the key themes of the United Nations Millennium Declaration, since the universal minimum targets deriving from that document concern the reduction of poverty, malnutrition, and maternal and infant mortality; extension of basic education coverage; gender equality in access to education; and greater access to drinking water.

One factor that helps to account for the unevenness of progress in the area of human development (especially in terms of life expectancy and level of education) and the failure to make headway in the reduction of poverty and inequality is that advances in the fields of health and education are only achieved through sustained efforts over several decades to set up and consolidate State institutions and programmes aimed at achieving universal coverage (especially for primary health care, access to basic services and formal education). It is therefore difficult to attribute failures or successes to any one Administration, since the present situation is the outcome of those initiatives' cumulative effects. Clear examples include Chile, Costa Rica and Cuba, whose public health systems have been strengthened over time and have long been oriented towards achieving universal coverage. This approach has led to significant progress in reducing infant, child and maternal mortality and in raising life expectancy.<sup>15</sup> Other types of advances can be achieved more quickly. Effective literacy programmes, such as the one launched by the Bolivarian Republic of Venezuela at the start of the decade, are one example of the latter, since they can quickly bring

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<sup>11</sup> ECLAC Database on Social Statistics and Indicators (BADEINSO), on the basis of figures from the UNESCO Institute for Statistics.

<sup>12</sup> ECLAC Database on Social Statistics and Indicators (BADEINSO).

<sup>13</sup> Ibid, on the basis of data from the WHO/UNICEF Joint Monitoring Programme on Water Supply and Sanitation.

<sup>14</sup> It should be pointed out that there are still poor areas, especially in rural areas of the region's poorest countries, whose access indicators to some of these goods and services are similar to those in Asia or Africa.

<sup>15</sup> Because of their long-term scope and soundness, these projects has sometimes led, paradoxically, to improvements in certain kinds of education and health indicators even during periods of recession or high economic volatility, such as during the "debt-crisis decade".

about a dramatic reduction in adult illiteracy. Another would be mass oral rehydration programmes, which can be implemented on the spot at little cost and can drastically reduce infant mortality due to diarrhoea in children aged between 0 and 2 years.

The time it takes for social protection measures to bring about reductions in poverty levels can vary enormously. For instance, a monetary transfer policy targeting the poorest households can improve poverty or extreme poverty indicators very rapidly by raising the incomes of a substantial portion of the population to levels above indigence and poverty thresholds calculated on the basis of household income. The same cannot be said of policies aimed at increasing human capital (education and health), whose effects are calculated on the same basis but may not be reflected until the next generation, when the current beneficiaries of an improved education enter the labour market with better prospects and earnings capacity. The health sector provides a good illustration of this point, since significant improvements in health indicators can occur while poverty levels remain relatively constant. This is attributable to the fact that poverty is calculated on the basis of household income; a quite different picture would result if indicators based on basic needs, human development or social capital were used instead.

Another aspect to take into consideration is the relationship between the pace of economic growth and level of per capita income, on the one hand, and improvements in the quality of life, on the other. In Latin American countries, there is a trend correlation (albeit inconclusive) between per capita income and indicators such as life expectancy, overall malnutrition and poverty and extreme poverty rates. The correlation has many exceptions, both in Latin America and elsewhere: the United States, for instance, has the highest per capita income but is outperformed by many other industrialized countries in terms of life expectancies and levels of learning in basic education. Costa Rica, which is a middle-income country within the region, has the highest life expectancy in Latin America and the Caribbean. It therefore seems to be the case that, besides per capita income, the distribution structure and the level and characteristics of public spending are determining factors in whether the whole of the population has access to public goods and exhibits better quality-of-life indicators. The correlation between per capita income and basic indicators of well-being or quality of life is thus not entirely linear, and there is manoeuvring room for redirecting policies so as to place greater emphasis on extending economic, social and cultural rights. This is all the more true because broadening access to those rights is largely dependent on the supply of global public goods such as economic stability and access to financing, as well as health care, education and basic services (ECLAC 2000a and ECLAC 2002).

The scope and structure of social spending can have a strong effect on the distribution and coverage of social rights. Naturally, some categories of social spending are much more beneficial for poor people than others (e.g., basic education, nutrition and subsidies for basic housing), while the effects of other measures are concentrated in other income groups, as in the case of social security benefits. It is also important to target some items of expenditure on the most disadvantaged groups in terms of access to these public goods (such as areas or schools with extremely low educational achievement levels). Therefore, the “increased social expenditure” indicator must be supplemented with an indicator that gauges “types of expenditure” in order to be able to determine how much priority a given policy places on economic, social and cultural rights.<sup>16</sup> One of the key challenges in this respect is to improve social protection within the framework of a responsible fiscal policy. This implies increasing the tax burden within the restrictions imposed by a globalized economy and boosting the efficiency of public policy. Chapter II includes an analysis of the available options in terms of taxation, given the wide range of different systems that are in use in the various countries.

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<sup>16</sup> See the analysis of the redistributive effects of social spending in the *Social Panorama of Latin America, 2005* (ECLAC, 2005a).

Particular importance has been placed on increasing social spending in recent years. It has been suggested that the most decisive factor in contributing to the well-being of the people who bear the brunt of the “social debt” is not the progressiveness of the tax structure, but rather an efficient, effective and focused social policy that transfers resources and assets to the poor. Although the enhancement of social spending and efficient resource use are a step in the right direction, that is no reason to rule out the “tax option”, especially not on the grounds that it would have a negative effect on investment and competitiveness, since, in most of the region’s countries, the tax burden is actually either comparatively or extremely low. Development efforts based on social rights should therefore aim to strengthen both social spending and progressive tax structures while maintaining a position of fiscal responsibility and providing an adequate stimulus for competitiveness.

## A social protection covenant

Greater equity and the extension of social protection have positive effects on the economy in more ways than one (Bonilla García and Gruat, 2003). First of all, as previously mentioned, more and better access to education and health raises the average level of human capital, which is crucial for sustainable growth and competitiveness in a world that increasingly values intelligence and innovation. It is also a decisive element in raising national economies’ average productivity. These are necessary conditions for the transition from spurious competitiveness (i.e., competitiveness based on low wages and over-exploitation of natural resources) to a genuine form of competitiveness based on the incorporation of intellectual value added (ECLAC, 1990; ECLAC/UNESCO, 1992).

Second, the greater the extent of social protection provided and the more secure social rights are, the less conflict there will be, or, in other words, the more willing members of society will be to find ways of resolving distributive disputes through negotiation, rather than resorting to other means of settling them that could undermine governance. Thus, a more equal distribution structure reinforces political stability and is therefore conducive to higher levels of external and domestic investment and financing. Third, greater equality indirectly lowers the high costs of poverty and inequality in terms of school drop-out rates, avoidable morbidity and unwanted pregnancies. In addition, a social protection system that offers more equitable coverage against risks and more equal opportunities for human capital formation boosts institutional confidence and reciprocity among the members of society. This, in turn, bolsters the supply of social capital, which is also an important force in generating virtuous circles between greater social confidence and increased economic dynamism.

If the members of society have a clear understanding of the virtuous circles that can be formed by equity and growth and by enhanced social citizenship and better governance, it will be all the easier to build a social covenant or contract. According to Devereux (2002), social protection systems are more solid when they are based on a concept of political community and solidarity within the framework of a hypothetical “social contract” between the State and its citizens. The redistribution required to finance social protection instruments is more politically viable if it is based on a common understanding regarding the rights and duties shared by all citizens. This would include an acknowledgement that everyone must pay taxes and respect the rights of others and that everyone should be protected equally in times of hardship, or that social policies should have a stronger and better impact (Sen, 2000).

The need for a social covenant stands out all the more clearly because the absence of a linear correlation between per capita income and the basic indicators of well-being and quality of life suggests that there is indeed scope for redirecting policies towards the expansion of economic, social and cultural rights. In other words, access could be extended to public goods such as vaccinations against childhood diseases, prenatal care and basic education even without any

substantial increase in per capita income. Most of the region's countries also have the potential to expand the range of areas (the tax burden, the structure of taxation, and the distribution, targeting and efficiency of public social spending) in which redistributive State action can be taken with a view to universalizing the effective exercise of social rights.

## Forms of social protection in welfare States

The first social protection covenant was established under the aegis of the welfare State in Europe and North America. As pointed out by Esping-Andersen (1993, 1996 and 2000), it is possible to have social policies without a welfare State, but there can be no welfare State without social policies. The difference between European and North American countries, as opposed to their Latin American counterparts, is that, in the former group, the welfare State has a strong and stable institutional nucleus that guides change, while Latin American institutions and programmes are not structured around a strategic set of long-term social measures and objectives (Galiani, 2006).

In Europe, the United States and Canada, social policies are implemented as part of the ideological framework of social and political agreements that make up their welfare systems. In Latin America, on the other hand, social policies need to be more closely interlinked on the basis of an ideological foundation capable of providing strategic guidelines, continuity and coherence that extend beyond the horizon of individual presidential Administrations. In Europe and North America, the contract between the State and society includes an agreement about the way each country has historically upheld its citizens' rights. In Latin America, on the other hand, social policies do not have the status of State policies (except in the few cases where sectoral budgets are "armour-plated"), and there is no social authority of the same rank as the most senior economic decision-makers.

The welfare States that emerged in the developed world between the 1930s and 1960s were established in response to the need for social protection systems capable of dealing with the risks of the time, which were tied in with the central role of employment in the definition and satisfaction of individual rights (see box I.2). Since the 1970s, however, changes in terms of production, employment, epidemiological and demographic profiles, families and gender roles have cast doubt upon the validity of the traditional employment-based welfare State (the Bismarckian model). These changes forced the issue of the need for reforms to protect citizens' rights from the new social risks they brought with them. These reforms would have to be carefully crafted in order to ensure that they did not exclude portions of the population from the social protection system (Titelman and Uthoff, 2005).

Within this context, the concept of security goes beyond the bounds of its traditional definition to include new factors such as age and ascriptive categories such as gender and ethnic minorities. This concept is increasingly linked to citizenship, human rights and the deepening of democracy, and it comes into conflict with the new economic constraints stemming from the emerging global order and the present degree of financial volatility.

## Box I.2

**THREE PARADIGMATIC MODELS OF THE WELFARE STATE**

In analysing the development of the welfare State since the 1930s, Esping Andersen identifies three types of welfare regimes in the industrialized world. Each of these regimes corresponds to a solidarity model that reflects the way in which the welfare State deals with risks.

The *liberal welfare regime* minimizes the State, individualizes risks and promotes market solutions within a framework of residual risk management. The United States is an emblematic example of this model, which has three main characteristics. First, it is residual (in Latin America, this concept is referred to as the “subsidiary role” of the State), in that it deals only with unacceptable risks and tailors its protective measures to the groups exposed to those risks. Second, it often involves social policies that target extreme poverty and whose focus is based on people’s needs rather than their rights. Third, there is a tendency to apply welfare policies that use means testing to determine the presence of need. This criterion is used not only in the United States but also, to varying degrees, in other countries whose welfare States have originated from liberal regimes, such as Australia, the United Kingdom, New Zealand, Canada and Ireland.

The *social democratic regime* used by the Nordic European countries has a universalist, egalitarian orientation and is committed to the notion of rights. Rights are linked to individuals and are based on citizenship; in the United Kingdom and the Netherlands, in contrast, pensions are based on effective contributions rather than on demonstrated need or employment contracts. The system seeks to de-commodify welfare or well-being in order to minimize dependency on the market. Some countries (such as Belgium and Italy) have subsidies that are almost as high as in the Nordic countries, but what distinguishes the Nordic countries’ social democratic regime is its fusion of universalism and of the overall socialization of risk with generous subsidies and universal coverage.

The *conservative (corporatist) regime*. The most obviously conservative aspects of this system are its risk distribution (corporatist solidarity) system and familialism. The former is reflected in a distinctly Statist historical legacy that provides special treatment to civil servants and additional social security resources based on corporatist interests. Although the basis of pensions is not strongly corporatist in Germany, there are thousands of special health funds for particular regions, professions or companies. Italy, on the other hand, has a unified health system but over a hundred pension plans for various professions. Such systems can also be based on familialism, which prioritizes the central role of the family as caregiver and, ultimately, as the unit responsible for the well-being of its members. As with the liberal model, the conservative regime is also residual. However, while the liberal system provides coverage for market failures, the conservative model provides for “family failures”. In both cases (and unlike the social democratic system), assistance (need) takes precedence over rights.

**Source:** Gosta Esping-Andersen, *Fundamentos sociales de las economías postindustriales*, Barcelona, Ariel, 2000; *Welfare States in Transition*, London, Sage, 1996; *Changing Classes. Stratification and Mobility in Postindustrial Societies*, London, Sage, 1993.

### **The social State and social protection in Latin America and the Caribbean: legacy of the 1980s, assessment of the 1990s and uncertainties of the twenty-first century**

Following the Second World War, Latin American and Caribbean countries joined in the effort to forge a social State. The rate of progress made in this area varied from country to country, however, and differing paths were taken in terms of institution-building and the coverage of public social services. In addition, the informality of the labour market limited the coverage provided by job-based benefits. Only some of the region’s countries succeeded in setting up a social policy system of progressive and continuous coverage.

The partial welfare-State model implemented between the end of the Second World War and the mid-1970s was based on the notion of a labour-based society. This presupposed an ideal situation of full and increasingly formal employment as the basis for a social protection system that would gradually provide more and more benefits to the workforce. These benefits were to be paid for out of State, employer and worker contributions, with the assumption being that these workers (heads of household) would provide for their entire family with their income and social protection benefits. Social citizenship was to be linked to “labour citizenship”, and it was the State’s job to provide universal coverage of basic services and formal education.

This model was always a partial one. First, because the high level of labour informality left a large proportion of the population without the job-based social protection it was designed to furnish. This situation was then exacerbated by the negative impact of crises and economic volatility on employment. Second, the model did not specifically take into account such groups as women, the poor and families in general. Third, the State began to run up against serious shortages of resources (particularly from the “lost decade” or the “decade of the debt crisis” onward), in addition to the cumulative policy inefficiencies associated with such phenomena as excessive bureaucracy, clientelism and corporatism.

This, combined with the “fiscal rationalization” agenda that burst onto the scene in the wake of the economic reforms of the 1980s, redefined the “social State” and social policy. The causes of the shift away from the social State in Latin America and the Caribbean that are cited in the literature include the difficulty of using solidarity-based funding mechanisms to finance universal social benefit systems; inefficient State management; a spiral of increasingly complex pressures and demands whose scale and specificity made them exceedingly difficult to cope with; breakdown of the full-employment paradigm; changes in market rules; sociodemographic shifts; and new expectations on the part of the population.<sup>17</sup>

Since the 1980s, all of the above has led to sweeping reforms of the State and social policy. The most important changes have been the decentralization of government services, policies and decision-making, increased direct private-sector involvement in service management and delivery, the targeting of programmes for the poorest groups through social welfare policies, and the rationalization of expenditure through new management, information and monitoring tools.

As will be discussed in greater detail later on, in the 1990s almost all the countries increased their per capita social spending levels. They also fine-tuned the targeted welfare policies launched in the 1980s by introducing new instruments designed to tackle different dimensions of poverty through the use of social funds in such areas as housing and habitability, services, roads and basic social infrastructure, microfinance and production equipment. New services were also created for certain disadvantaged groups (women, children, older adults, people with disabilities, microentrepreneurs, small-scale farmers and indigenous groups). Budgetary restrictions forced such programmes to target subgroups within those categories, however, and these initiatives therefore metamorphosed into pilot programmes that had some qualitative effect but that fell far short of achieving universal coverage.

In the region as a whole, compensatory measures became the policy of choice in the 1980s and part of the 1990s. This had the effect of blocking a comprehensive structural reconfiguration of social policy. The region’s countries tended to treat targeted policies as stable policies —an approach that gave rise to policy overlaps with sector-specific State institutions.

Now, at the start of the twenty-first century, the performance rating for the “social State” (i.e., the overall package of public social policies) is not particularly positive in terms of poverty levels and income distribution. It has, however, been much more successful in terms of increased social spending, policy reform efforts, institutional development and the creation of new management tools. Moreover, it is now widely recognized that people do not escape from poverty “once and for all”, given the realities of economic volatility, gaps in terms of human capital, employment constraints and the fact that growth does not automatically form a virtuous circle with poverty reduction. It is in this context that ECLAC is advocating the formation of a broad covenant of social cohesion (ECLAC, 2004b) (see box I.3).

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<sup>17</sup> See Titelman and Uthoff (2005) and the following chapter.

## Box I.3

**A SOCIAL COVENANT AND A FISCAL COVENANT: ECLAC PROPOSALS**

As long ago as the early 1990s, ECLAC was underscoring the need for a strategic consensus embodying a set of long-term explicit and implicit agreements between the State and major political and social stakeholders regarding instrumental objectives and the sequencing of the policy measures and institutional innovations needed to achieve them (ECLAC, 1990). The reasoning behind this idea is that successful policymaking and policy implementation require the institutional framework and backing that these types of agreements can provide.

The notion of fiscal and social covenants or contracts has been referred to repeatedly by ECLAC ever since then. A position paper presented at the thirtieth session of the Commission, held in San Juan, Puerto Rico, advocated the establishment of a social cohesion covenant in order to avert the negative effects—especially in terms of social protection—of the necessary adaptability of labour markets. This covenant would form the basis for a set of “social and economic policies, hinging on a social cohesion covenant resting on four pillars: consistency with the foundations of macroeconomic policy; job creation; social protection; and education and training” (ECLAC, 2004b, p. 302). In the area of social protection, a social cohesion covenant would include insurance coverage for unemployment, disability, old age and death and would provide access to health services and coverage in keeping with the new risk profiles associated with changes in the production structure.

The covenant should reflect an awareness of the fact that labour policies do not, on their own, create jobs and therefore need to be backed up by a recovery in employment demand and active policy measures. Unless labour flexibility is coupled with rapid growth in demand, then appropriate unemployment insurance should be provided, in conjunction with public employment policies and support policies for the informal sector. In order to formulate an agreement that takes into account a social protection system’s current stage of development and the need to gradually introduce active policies targeting the formal and informal labour markets, any proposals in this area must be adapted to the particular conditions under which they are to be applied (ECLAC, 2004b, p. 302).

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), *Productive Development in Open Economies* (LC/G.2234(SES.30/3)), Santiago, Chile, June 2004 and “The Fiscal Covenant: Strengths, Weaknesses and Challenges. Summary”, *Libros de la CEPAL series*, No. 47 (LC/G.2024/I), Santiago, Chile, April 1998.

An idea that has been swiftly gaining ground since the 1990s is that recipients of services and benefits are also citizens who are entitled to certain enforceable rights. The road to social citizenship is not free of contradictions, however. One key topic of debate is the targeting of social policy (or of many social programmes) for the poorest and most vulnerable groups. Initiatives of this sort may take the form of social emergency or social investment funds, emergency employment schemes, direct transfers of monetary subsidies to the poorest groups and educational programmes. They also include the use of socio-economic measurements to increase the accuracy of efforts to target those people who are the least integrated into social inclusion mechanisms.

The debate over universal policies versus those targeted at the poorest groups is multifaceted. In theory, targeting is supposed to enable policymakers to use specific measures to reach these groups, thus promoting a more progressive distribution of resources. It also concentrates public resources and efforts in the most progressively redistributive areas of social policy and encourages the self-financing of certain benefits for non-poor recipients. Regardless of whether policies focus on the poor, depressed geographical locations or areas that provide the greatest benefits to low-income groups, targeting always has a twofold purpose: to optimize resource use and to benefit those who live in the most precarious or vulnerable conditions.

The validity of targeting can be called into question, however, when it ceases to be a temporary measure and becomes an established standard of social policy, since prolonged targeting can lead to the consolidation of a welfare model that makes beneficiaries more dependent upon it. This runs counter to the ideal of social citizenship, which gives priority to the development of citizens’ abilities to increase their active participation in society and their power of self-determination.

It is therefore important to ensure that, once a certain level of development has been reached, targeting does not have the effect of encouraging poor people to continue living off State aid while continuing to exclude them from social integration circuits, especially those associated with the

attainment of self-sufficiency through employment. Incentives to seek work and build skills are essential to offset the negative side-effects of targeting. These effects include “the poverty trap”, whereby the poor remain in a dependent position indefinitely as beneficiaries of targeted policies or programmes.

Consideration also has to be given to the fact that, in the long run, egalitarian policies have been designed to provide universal coverage, as is clearly illustrated by the more equitable industrialized societies, where the most influential social model of the State is founded upon the idea of providing high-quality benefits to all citizens. In other words, egalitarianism is based on the universality of social citizenship, which entails access for all to quality benefits in areas such as health, social security, education, income supplements for the poor, unemployment insurance and family care. One of the advantages of universalism is that it spurs demands on the part of middle-income groups which tend to elevate the standards that the poorer groups expect such benefits to meet. It also gives rise to a closer correlation between social protection and social inclusion. This is because the continued implementation of high-quality universal social protection policies requires very active labour policies since, in the final analysis, employment-based protection pays for itself.

Although targeting, on the other hand, has redistributive effects in the short term, prolonging the implementation of such policies indefinitely is not the best means of moving towards more egalitarian societies. The greatest risk of such an approach is that it can give rise to a segmented regime in terms of the quality of benefits (one education system and one health-care system for the poor and another for the non-poor), thereby reinforcing inequalities between poor people and the rest of society in terms of life experiences and outcomes, even if equality of opportunity has been achieved.

When economic volatility, drastic adjustments in the labour market or economic reforms result in a massive and widespread reduction in the earnings of middle-income groups, it is fairer to concentrate on broad-coverage programmes in order to prevent a rise in the number of “circumstantially poor”, who may ultimately end up joining the ranks of the “structurally poor”. On the other hand, the privatization of health and social security systems, which tends to result in the quantity and quality of benefits being based on the contributory capability of the recipient, leaves a wide segment of the population in a less protected and more insecure position. Thus, when the targeting of the poorest individuals is combined with a system that relies on self-financing by other socio-economic groups, a significant number of middle-income households may find themselves stranded in a “no man’s land” in between, where they neither qualify as recipients nor have the resources to act as contributors. Furthermore, inefficient resource distribution may result in services of extremely uneven quality.

Nor should we ignore the necessary complementarities between targeted and universal policies. Given the needs that are common to all but that only some members of society can meet on their own, and in the light of the scarcity of resources, targeting definitely constitutes an effective short-term tool for levelling the playing field in terms of risks and vulnerabilities.

## **Towards a social protection covenant**

The notion of rights-based social protection is not limited to welfare or relief measures. It also encompasses policies for the development of human capital and risk prevention. Although changes in social policy have resulted in a more educated population and improved health indicators in Latin America and the Caribbean, people nonetheless find themselves in volatile, segmented, precarious labour markets over which they have no control, while society itself must cope with processes that extend beyond the purview of political decision-making at the national level and that may trigger fluctuations in the economy’s growth rates and job creation capacity.

In this context, social policies must help society overcome its vulnerabilities and mitigate the factors that create insecurity under different sorts of circumstances, which will have varying impacts on individual members of society depending on how vulnerable their positions are. This calls for anticipatory and remedial social investment measures in order to strengthen human and social capital, reinforce employment-based social security schemes, and build social protection and and/or safety nets.

This also suggests that, at this juncture, the region needs to make the transition from a social policy package to a comprehensive social protection system. This transition poses both fundamental and procedural problems, however, including the conflicts that arise among rights, resources, distributive patterns and institutional designs. As noted earlier, no solution is universal, and there can be no effective exercise of social rights without according due consideration to supply of resources available for distribution and the exogenous and endogenous constraints existing in each country and at each point in time.

A protection system is more than an institutional structure; it is a political agreement that enables society to lay the foundations for building and regulating its way of life. This kind of system determines which rights apply to all, how they are protected and how they are rendered viable. This involves institutions, standards, programmes and resources. Furthermore, a social covenant aimed at reshaping social protection on the basis of universally recognized rights is not simply a matter of having individuals decide to enforce such rights or of market dynamics. A social covenant of this kind must be backed up by a society-wide decision to uphold such rights.

A social agreement or covenant must therefore include a common vision of the type of society that the State and all stakeholders aspire to achieve. This is necessary for two reasons. First, the sheer scale of such a task requires a broad national consensus in order to implement the necessary social reforms (institutional innovations, determination of resource levels and allocation, and the definition of how the principle of solidarity is to be expressed in actual transfers).<sup>18</sup> Second, long-lasting policies and institutions are needed whose time horizons extend beyond the terms of individual Administrations.

The main means of consolidating social policies in the medium and long terms is therefore this type of social (and fiscal) covenant or pact. “Armour-plating” the most important items of social spending has a twofold purpose. First, the established priorities reflect an explicit political agreement reached by Congress; second, funding for such items is guaranteed and the continuity of the relevant programmes is therefore ensured.

Such a covenant has both substantive and procedural aspects. The former refers to content (minimum levels, tangible manifestations of solidarity, transfers, the progressivity of coverage, quality of benefits and expansion of access). A social protection covenant must be based on the principles of universality, solidarity and efficiency. This does not mean that every single benefit can be provided to all, but rather that, on the basis of a dialogue among all stakeholders, society reaches agreement as to the standards of quality and coverage that should be guaranteed to all its members. Such a covenant should also feature clear and permanent rules and management standards. It should adhere to criteria for the maintenance of macroeconomic stability and be aimed at socializing benefits and obligations. Stable and dynamic economies, combined with effective solidarity-based transfers designed to universalize social protection and promote the development of capacities and opportunities, are absolutely essential if the region is to reconcile the two sides of the development coin: growth and equity.

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<sup>18</sup> Any serious analysis of social protection or a welfare system in Latin America cannot ignore the political debate concerning a fiscal covenant. See ECLAC (1998) and ECLAC (2004b).

The procedural aspects have to do with the way in which the idea of forming such a covenant is proposed, who is called upon to participate, what kinds of deliberative and representational procedures are to be used, how agreements are to be monitored and applied, and how the State is to fulfil its regulatory role. Without such agreements or covenants, any progress made in this regard will be subject to the ins and outs of ongoing negotiations, with no guarantee of continuity over the medium term and questionable social legitimacy. This would make it impossible to move ahead in building a social protection system that could serve as a framework for such policies and lay the foundations for coherent and consistent linkages between social and economic policies.

Covenants of social protection and cohesion are concluded among organized stakeholders in coordination with the State. The most organized groups within the production sector (trade unions and business associations) are not the only actors linked to the State and political system, however. This is partly because modernization and globalization have weakened trade unions and their linkages with the political system. Another factor is that these same processes have produced a more complex map of social actors as new ascriptive groups based on factors such as geographical location and age have emerged. It is also vital to bring representatives of excluded groups, especially informal workers, to the table. This poses another challenge for democracy: the challenge of raising the profile of “invisible” stakeholders or, in other words, levelling the playing field in terms of active participation in decision-making. Finally, since participation in public affairs is increasingly taking place at the local level (in the “global village”), any deliberative process undertaken with a view to forging a covenant of social inclusion or cohesion should also include local actors from the public and private sectors.

Political parties have a key role to play both in appraising and in building such a covenant. From the standpoint of the critical assessment of such an agreement’s contents, however, political parties in many of the region’s countries have lost some of their ability to represent social demands and have become overwhelmed by de facto power groups and the proliferation of actors whose demands are increasingly difficult to merge into a single voice. The vital nature of political parties’ role in constructing a social protection covenant stems from the fact that they are the ideal channel for mediating and formalizing relations between the State and civil society, or between the disperse logic of social actors and the more coherent logic embodied in consensus-based political proposals.

It is just as important to promote the stability and reinforcement of the democratic system and its institutions as it is to define the guidelines, foundational criteria and tools to be used by a social protection system. These elements constitute the underpinnings for a social covenant whose point of departure is a consensus regarding the solidarity-based measures to be used in sharing the costs of crises and in distributing the benefits of progress more fairly and equitably. By the same token, in order for democracy to enjoy legitimacy, economic and social organization issues need to be taken into account as part of the initial deliberative process. Economic and social policies must be backed up by greater political control and technical capacity in order to orient the economy towards the interests of the entire populace. The formation of such a covenant thus implies that political and social actors will furnish the necessary support to give policies a solid foundation and ensure their continuity. As such, it constitutes a vital link between social protection policies and the strengthening of democracy (see box I.4).

Box I.4  
**DEMOCRACY, THE ECONOMY AND POLITICS**

There can be no effective democracy unless economic and social organization issues are included on the agenda. A substantive consideration of these issues is a fundamental component of any democratic system.

This line of reasoning has three main implications. First, it is hard to imagine a sound democracy in the absence of solid political parties capable of offering the electorate alternatives in terms of the economic and social order. Without such ideological competition, politics becomes, at worst, pure clientelism and, at best, an electoral contest between potential “public managers”. Perhaps these two concurrent trends and politics’ current lack of appeal are attributable to a loss of basic content. It is of vital importance to endow democratic systems with greater substance and thus reverse this trend in order to ensure that political action will meet development needs more effectively.

Second, in order to achieve this outcome, steps must be taken to ensure that the academic debate is a pluralistic one and to set up mechanisms capable of converting these technical debates into a social dialogue. To this end, interaction between academia and social organizations should be encouraged, and these kinds of discussions should be disseminated via the mass media.

Third, the strengthening of technical units or bodies and independent economic authorities must be accompanied by appropriate political oversight. One crucial area of endeavour in this regard involves measures for building the capacity to conduct such oversight properly. Priority must therefore be given to setting up technical support teams to advise members of Congress, political parties, trade unions, community organizations and business groups as a means of helping them deal successfully with technical departments and units within the governmental structure. This is a priority item on the democratic agenda that has received insufficient attention to date.

**Source:** José Antonio Ocampo, *Reconstruir el futuro. Globalización, desarrollo y democracia en América Latina*, Bogotá, D.C., Economic Commission for Latin America and the Caribbean (ECLAC)/Grupo Editorial Norma, October 2004.

There is no need for a social and political agreement to stipulate whether or not citizens are rights holders by definition or whether or not those rights should be protected automatically, since there is no question about either point. What should be specified, on the other hand, is which rights should be guaranteed for the whole of society and to what extent, given that society’s level of progress and the potential risks faced by its citizens. This obliges all stakeholders to subscribe to a principle of social solidarity as manifested in the intragenerational and intergenerational distribution of material and financial resources, access to health and education services, and risks and opportunities.

It is therefore more a question of which rights or what degree of enforcement should form the backbone of a renewable social covenant. In other words, what should the specific content of a social protection contract be at any given moment in time? In Latin America and the Caribbean, for instance, countries with a large number of people living in poverty or extreme poverty are unlikely to be able to extend their social protection policies to other at-risk sectors of society. For countries that have succeeded in sharply reducing their poverty levels, on the other hand, limiting social protection to the poorest groups might well be a regressive measure, especially given the size of middle-income sectors that, in the absence of support, would be at risk of job insecurity, low income levels or both.

This means that the substance of a rights-based social covenant or contract cannot be applied across the board to all countries in all circumstances. Although the rights themselves are universal, the standard of implementation that is judged to be adequate is determined by historical factors. Social contracts must therefore take these variations in time and space into account by adjusting to rising or falling levels of resources and to increases in the thresholds that must be crossed in order to lift people out of poverty, mitigate vulnerability and reinforce social inclusion. Furthermore, the starting point for a social protection covenant must be a recognition of the fact that the three principles of social protection systems (solidarity, universality and equivalence) must be in balance in order to permit the use of a proper mix of incentives. That balance is not an automatic given: it must be built and legitimized, and it is no mean feat to reach agreement as to an optimum

combination of incentives to encourage individual contributions and transfer mechanisms to serve the interests of solidarity and universality.

In summary, a covenant must seek to reflect a consensus regarding the following elements:

- A minimum threshold of social protection to which all members of society are to have access simply by virtue of their citizenship. This threshold should be set at a realistic level, however, in terms of the society's stage of development and viable levels of inter-sectoral redistribution and transfers.
- The rate at which this basic minimum is to be increased, together with the sequencing and progressiveness of the steps taken to do so. Consideration must be given to attaining a feasible level of resource redistribution, but efforts should also be made to expand the supply of available resources through economic growth. This approach will allow redistributive mechanisms to be used in combination with measures for safeguarding competitiveness and the sustainability of growth.
- Tangible manifestations of solidarity, although the exact mechanisms may vary from country to country. Precisely because there is no single, universally applicable model, it is very important to have an institutional structure with sufficient authority and legitimacy (from the standpoint of both the State and society) to implement the relevant social policies. What is at stake here is society's support for the regular use of mechanisms to carry out transfers between members of the economically active population and retirees on the basis of age, gender, employment status or income; between private contributors and public beneficiaries; between persons in high-income and low-income groups; between employers and employees; and between sectors that are covered by social protection systems and sectors that are not.
- State-enforced regulatory procedures to guarantee the effective use of these solidarity-based mechanisms. This may involve a suitable combination of public and private financing for benefits and services (including compensation funds); individual and public contributions (balancing incentives with transfers); taxation and the tax structure; and distribution of costs and benefits through labour reforms.
- A progressive social expenditure and taxation system that clearly defines the intended use of any increases in spending or taxes, which should be directed towards social investments that will clearly benefit the most vulnerable groups. Specific action should be taken to ensure that such resources are not used for other purposes.
- Agreed standards in relation to the social impact of funding increases. The job of upholding these standards should be assumed by the State as one of its obligations under the social covenant.

This kind of social protection involves two different rationales: one in which there is a fairly linear relationship between contributions and benefits, and one that clearly separates contributions from benefits through the use of taxes or crossed subsidies. In the first case, people expect to see a straightforward relationship between what each person contributes to social security and the benefits which that individual receives. The best examples of this linear relationship are individual risk insurance or individual funded pension systems. Such systems are based on the principle of individual equity.

The underlying rationale is quite different in the case of collective equity, the main example of which is a social assistance or welfare system. Under these sorts of schemes, contributions are collected through taxation, and benefits are not directly related to the amounts paid in by contributors. What is more, the people who receive social assistance benefits tend to be those who pay the least taxes throughout their working lives. Social assistance systems therefore function as a

redistribution mechanism for channelling transfers from the people who have the most to those who have the least. The definition of which rights are guaranteed and which risks society is willing to assume as its collective responsibility should lead to an explicit designation of public goods whose provision by the State—and only by the State—is indelegable, regardless of whether the delivery of such goods is conducted by public or private institutions.<sup>19</sup>

Within this framework, a social covenant or contract that sets acceptable standards of social protection for all citizens will invariably be situated somewhere along the line that stretches between the extremes of individual equity and social equity (i.e., between a direct correlation of contributions to benefits, on the one hand, and the social optimization of the benefits financed by total contributions, on the other). The ideal balance is one that facilitates the efficient mobilization of a maximum amount of resources while achieving or maintaining a distributional optimum in the use of those resources for the purposes of social protection.

As was stated at the outset, a social protection covenant is an equation in which social rights are the normative horizon, while existing inequalities and budgetary restrictions are the limiting factors to be dealt with. The ethical imperatives that underpin a social rights-based covenant must be reconciled with the financial constraints generated by the dynamics that will be described in the following chapters of this study. Another aspect to consider is the optimum use of resources to increase the coverage and quality of services, especially for those people with little or no access to them. The proposals put forward in this document are designed to build bridges between social rights and policies aimed at achieving simultaneous increases in access, financing and solidarity.

This study will therefore devote special attention to some of the main issues associated with social protection. The assessments and proposals regarding health and social security systems offered in the following chapters are based on the inclusive capacity of the labour market and support programmes for the poorest sectors of society. These inputs, which are the core components of this study, are designed to contribute to the definition of a modern social covenant or contract based on the right to social protection.

The following chapters do not cover a number of issues that are of key importance in relation to social protection and inclusion, such as education, human settlements, infrastructure and the provision of basic services. In the interests of producing a concise and thematically coherent analysis, the scope of this study has therefore been confined to the topics identified earlier. Nor does this analysis relate social protection to the United Nations Millennium Development Goals, since that subject has been covered in an earlier document on the follow-up to the Goals in Latin America and the Caribbean, which included contributions from a wide range of United Nations agencies active in the region and was coordinated and recently published by ECLAC (United Nations, 2005). In order to avoid any overlap, the aim has therefore been to make a specific contribution to an understanding of social protection issues relating to health, social security and direct transfers that are gaining political momentum in the region.

Whereas this chapter has focused on rights as a basis for examining the relevant data, the remaining chapters will move in the other direction using an inductive approach. The current situation is thus used as a starting point for exploring possible options and determining the optimum levels of social protection within existing constraints. This is not to deny the value and binding nature of social rights, as is underscored by the fact that the first chapter of this study has been devoted to that subject. Instead, the idea is to provide a historical context for the issue of social rights in the region, taking into account the countries' current possibilities, their available resources and the potential for distributing them in a way that optimizes protection without overlooking the importance of maintaining their economies' viability, sustainability and

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<sup>19</sup> The State must control, regulate and monitor the provision of public goods to ensure that they meet quality standards and are distributed to recipients in the quantities stipulated.

competitiveness. In the final analysis, after all, equity and balance are two sides of the same coin in terms of social protection.

ECLAC hopes that this study will provide substantive inputs for a social protection covenant by helping to reconcile resource constraints with the potential that public policies have to make a difference in people's lives. This first chapter has outlined the main groups within society that are called upon to help shape a social protection covenant. In the chapters that follow, stylized analyses will be used to arrive at a more detailed profile of these stakeholders. The aim is to put forward viable options for moving towards full and effective entitlement of men's and women's social rights in Latin American and the Caribbean by rectifying inequalities and managing the constraints and opportunities associated with the current phase of globalization.



## Chapter II

# Contributory dynamics, the labour market and challenges for fiscal policy

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## Introduction

The best way to guarantee people's economic and social rights is, undoubtedly, to provide them with decent work (ILO, 1999). However, the region's labour markets have not succeeded in becoming a universal or dynamic gateway to social protection. In fact, contributory social protection coverage in the region declined between 1990 and 2003. As there is unlikely to be a reversal in labour market trends in the short to medium term, there is an urgent need to gradually develop social protection systems that are not necessarily employment-based. Hence the importance of promoting non-contributory social protection mechanisms, which at present are limited by the general scarcity of fiscal revenues, since, as things stand now, large sectors of the population are excluded from formal protection schemes.

So, in addition to seeking ways to build the capacity of national economies for creating decent work, progress must be made in adopting measures to guarantee adequate and stable financing in order to supplement employment-based protection with non-contributory solidarity-based mechanisms.

To promote contributory social protection, the rate and stability of economic growth have to be improved, in addition to facilitating the formalization of employment and fostering policies to reconcile labour flexibility with social protection. Although it is important to have macroeconomic policies that will ensure employment levels and dampen their volatility over the long term, productive development policies can be used to help increase employment demand indirectly by improving the production apparatus (ECLAC, 2004b).

In order to widen the scope of social protection systems and meet the growing demand for non-contributory benefits, efforts need to be made to redeploy social expenditure or increase tax-based financing. This calls for progress towards the establishment of a political agreement focusing on the need to create a new social and fiscal covenant that will gradually increase the level of tax revenues without undermining the countries' economic competitiveness. Apart from tackling the problems that can sometimes arise when introducing new taxes or raising tax rates, important items on the agenda include eliminating or reducing exemptions, decreasing tax deductions and improving the administration of the tax system.

While the extension of social protection coverage depends largely on the viability of expanding and formalizing labour markets and on improving public finance, as well as on properly-managed social policies, other factors put added pressure on protection systems. Two of the main such factors are the demographic transition and the changes taking place in the region's households.

This chapter will examine the available data on contributory social protection coverage in Latin America and the Caribbean. It will then go on to analyse the challenges posed by the dynamics and expansion of the labour market, the nature of social expenditure and the possibilities for increasing public funding for social policies.

## Contributory social protection coverage

Even though social security systems have been in operation in Latin America and the Caribbean for many years, existing contributory social protection systems cover only a fraction of male and female workers. The situation is even more complex in rural areas and among workers in the informal sector. In fact, not even workers in formal urban jobs or in high-productivity sectors have guaranteed contributory protection. In addition, gender-based social constructs that delegate unpaid domestic work and childcare to women hinder their entry into the workforce and, as a result, they must often rely on their spouses for access to contributory social protection services. Consequently, owing to the limited ability of the poorest sectors of the region's population to generate adequate income and to secure high-productivity jobs, contributory coverage is closely linked with how households are positioned in terms of income distribution. In other words, income inequality is transposed to the social security sphere as inequality in contributory coverage. This situation has lately become even more serious. This fact is reflected in the recent trend of these indicators, which show that, since 1990, there has been a decline in the levels of contributory social protection coverage among the employed population.

## Current situation

Table II.1 shows the proportion of employed men and women who pay into a contributory social security scheme in 16 countries of the region. While there are marked differences across countries, the simple average indicates that only 38.7% of the employed population is covered.<sup>1</sup> This percentage is significantly lower in the case of rural workers (21.9%), urban employees in small firms, and domestic service workers (wage-based informal sector, 21.7%), and lower still in the case of own-account workers, unpaid family workers or small business owners (non-wage informal sector, 13.5%). Public-sector workers and urban workers in high-productivity sectors (medium-sized and large enterprises, professionals and technicians, and owners of firms with more than five workers) are far better off in terms of contributory coverage. However, protection is far from universal, with coverage, measured as a simple average, of 68.2%, while in some countries the rates are less than 50%.

Table II.1  
**LATIN AMERICA AND THE CARIBBEAN: SOCIAL SECURITY COVERAGE**  
(Percentage of employed population paying contributions)

| Country  | National total    | Total-urban areas | Total-rural areas | Urban formal sector <sup>a</sup> | Wage-based urban informal sector <sup>b</sup> | Non-wage urban informal sector <sup>c</sup> | Total men         | Total women       |
|--|-------------------|-------------------|-------------------|----------------------------------|---|---|-------------------|-------------------|
| Argentina (2002, urban areas) <sup>d</sup>             | ...               | 56.0 <sup>d</sup> | ...               | 68.5 <sup>d</sup>                | 22.7 <sup>d</sup>                             | ...   | 59.0 <sup>d</sup> | 52.5 <sup>d</sup> |
| Bolivia (2002)   | 14.5              | 21.2              | 4.6               | 42.8                             | 6.8   | 10.4  | 13.8              | 15.4              |
| Brazil (2001)  | 47.8              | 54.3              | 17.4              | 78.3                             | 34.4  | 17.1  | 48.4              | 47.0              |
| Chile (2003)   | 64.9              | 67.0              | 48.8              | 81.6                             | 50.8  | 20.7  | 66.6              | 62.1              |
| Costa Rica (2002)                                      | 65.3              | 68.2              | 60.5              | 87.7                             | 43.3  | 35.0  | 68.5              | 59.3              |
| Ecuador (2002, urban areas)                            | ...               | 32.3              | ...               | 57.4                             | 12.8  | 10.9  | 32.4              | 32.0              |
| El Salvador (2001)                                     | 32.9              | 43.4              | 14.5              | 78.5                             | 10.9  | 11.0  | 30.9              | 35.9              |
| Guatemala (2002)                                       | 17.8              | 31.1              | 8.5               | 63.6                             | 10.0  | 0.3   | 18.4              | 16.7              |
| Mexico (2002) <sup>d</sup>                             | 55.1 <sup>d</sup> | 64.8 <sup>d</sup> | 30.8 <sup>d</sup> | 81.9 <sup>d</sup>                | 25.5 <sup>d</sup>                             | ...   | 52.9 <sup>d</sup> | 59.1 <sup>d</sup> |
| Nicaragua (2001)                                       | 18.3              | 25.1              | 7.6               | 53.8                             | 7.4   | 1.3   | 16.3              | 21.9              |
| Panama (2002)  | 53.8              | 66.6              | 29.3              | 88.4                             | 36.5  | 26.4  | 48.6              | 63.4              |
| Paraguay (2000)  | 13.5              | 20.2              | 5.0               | 48.9                             | 4.1   | 0.8   | 13.1              | 14.2              |
| Peru (2001)  | 13.0              | 18.7              | 2.6               | 43.8                             | 3.8   | 3.2   | 15.0              | 10.4              |
| Dominican Republic (2002) <sup>d</sup>                 | 44.7 <sup>d</sup> | 48.0 <sup>d</sup> | 32.7 <sup>d</sup> | 52.6 <sup>d</sup>                | 14.8 <sup>d</sup>                             | ...   | 43.4 <sup>d</sup> | 46.6 <sup>d</sup> |
| Uruguay (2002, urban areas)                            | ...               | 63.8              | ...               | 88.2                             | 43.9  | 24.7  | 63.6              | 64.0              |
| Venezuela (Bolivarian Republic of) (2002) <sup>d</sup> | 61.5 <sup>d</sup> | ...               | ...               | 75.5 <sup>d</sup>                | 19.9 <sup>d</sup>                             | ...   | 58.0 <sup>d</sup> | 67.1 <sup>d</sup> |
| Simple average   | 38.7              | 45.4              | 21.9              | 68.2                             | 21.7  | 13.5  | 40.6              | 41.7              |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

**Note:** The survey variables used to define the social security contribution vary from one country to another: contribution or affiliation to a pension system (Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Paraguay, Peru and Uruguay), contribution or affiliation to a national social security system (Costa Rica, Ecuador, El Salvador, Guatemala, Nicaragua and Panama), entitlement to “social benefits” (severance/retirement accounts) (Bolivarian Republic of Venezuela) or employment under the terms of a signed contract (Dominican Republic).

<sup>a</sup> Formal sector: Wage earners in the public sector and in firms having more than five employees, professional and technical own-account workers, and owners of firms having five or more employees.

<sup>b</sup> Wage-based informal sector: Employees of firms with fewer than five employees and domestic service workers.

<sup>c</sup> Non-wage informal sector: Own-account workers who are not professionals or technicians, unpaid family workers and owners of firms with fewer than five employees.

<sup>d</sup> Workers’ social security contribution rate, excluding own-account workers, unpaid family workers and business owners.

<sup>1</sup> The data used in the empirical analysis in this section relate to people aged 15 to 64. The simple averages in table II.1 refer only to countries with representative surveys at the level concerned. The totals for men and women are national or urban averages, depending on the characteristics of each country’s survey.

The low contribution rate of workers in the informal urban sector, especially non-wage workers, is highly significant because, on average, they represent 48.6% of the region's urban employed population (non-wage workers represent 30.8%). This means that virtually half of all urban workers are employed in sectors of activity where fewer than 20% pay social security contributions.

Even though, on average, the contributory coverage rate is very similar for all employed men and women, the figures mask significant gender differences arising from the large gaps in contributions by women associated, in most cases, with time taken off to care for children, elderly adults and disabled persons.<sup>2</sup> When the data are applied to the entire working-age population, which includes both the economically active and inactive populations, then a significant gender-based contribution gap is observed in the region, and this gap increases as the age scale rises. Only 19% of women between the ages of 15 and 64 pay social security contributions, compared with 32% of men (see figure II.1).<sup>3</sup> In terms of activity, employment and dependents, the situation of women in the labour market is such that it limits opportunities and incentives for the poorest women to join the labour market and contribute to social security (Cruces and Galiani, 2005). This is a key factor when it comes to assessing levels of equity in the region's contributory pension systems, since the large proportion of women who devote themselves exclusively to caring for others, child-rearing and housework tend to be partially excluded from social security systems, unless they have been married or have lived with a man for a long time, and provided that they meet a series of requirements, including not remarrying or having children with the contributor or pensioner. The only other hope for such women is a welfare pension, an option that is virtually non-existent in some countries (ECLAC, 2004c).

Apart from women's greater difficulty in entering the labour market, the type of employment is yet another factor that contributes to the lack of social protection for women workers in Latin America and the Caribbean. In most of the countries under consideration, proportionately more women than men enter low-productivity sectors of the labour market in activities where there is usually little contributory social security protection (see figure II.2).

Contributory coverage clearly reflects labour market patterns, given that more experienced or more educated workers who are in the employ of larger enterprises or in sectors with greater job stability are more likely to pay contributions.<sup>4</sup> The conclusion from the econometric analysis presented in box II.1 is that, even after controlling for demographic and geographic factors, employment factors are a significant determinant of the probability of paying social security contributions. An analysis by sex shows that the influence of experience and education on contributory behaviour is greater in the case of men than of women, meaning that, in terms of contributory social protection coverage, the labour market accords more value on the acquisition of a better education and greater experience by men than by women.<sup>5</sup>

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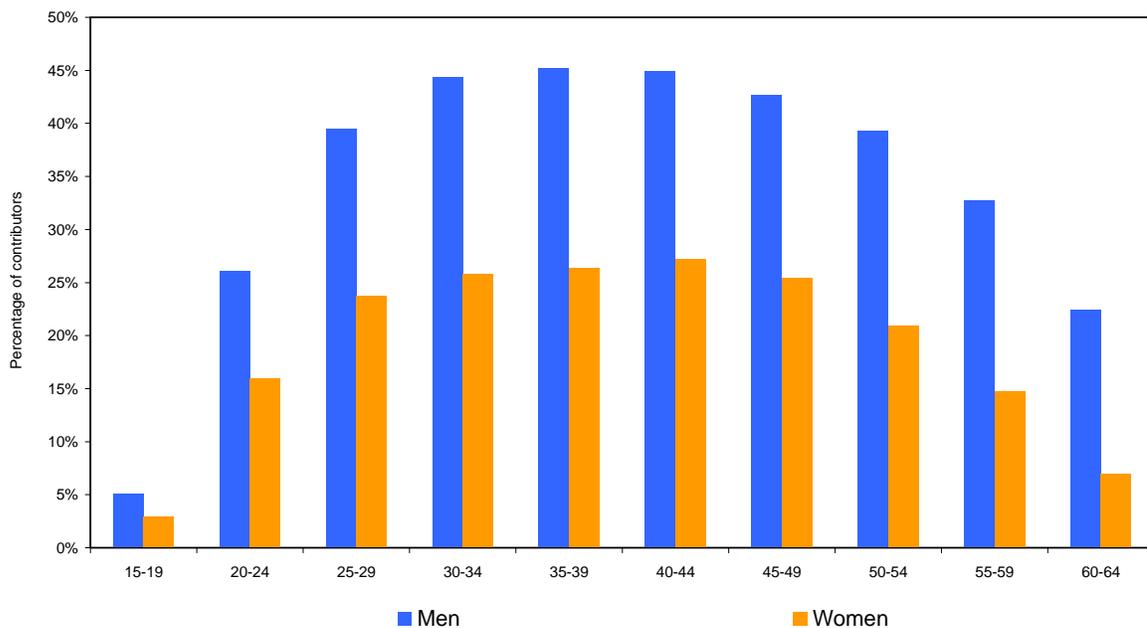
<sup>2</sup> There are, however, marked gender differences in and between countries. While coverage for men is substantially higher in some countries (Argentina, Costa Rica and Peru), in others the reverse is true (Bolivarian Republic of Venezuela, El Salvador, Mexico and Panama).

<sup>3</sup> Some of the most important explanatory factors relate to higher inactivity rates among women in low socio-economic strata. Apart from cultural factors, this may be attributed to the greater opportunity cost and lesser benefits for women in joining the labour force. Indeed, the childcare burden on poor households is far more than double that of well-to-do households. In turn, lower education and training levels lead to pay rates that fail to offset the possible cost of leaving underage children in the care of others. Lastly, there is a lower probability of women finding work, which discourages them from participating in the labour market.

<sup>4</sup> Using data from 14 countries in the region for the period 2000-2003, Rofman (2005) arrives at similar conclusions.

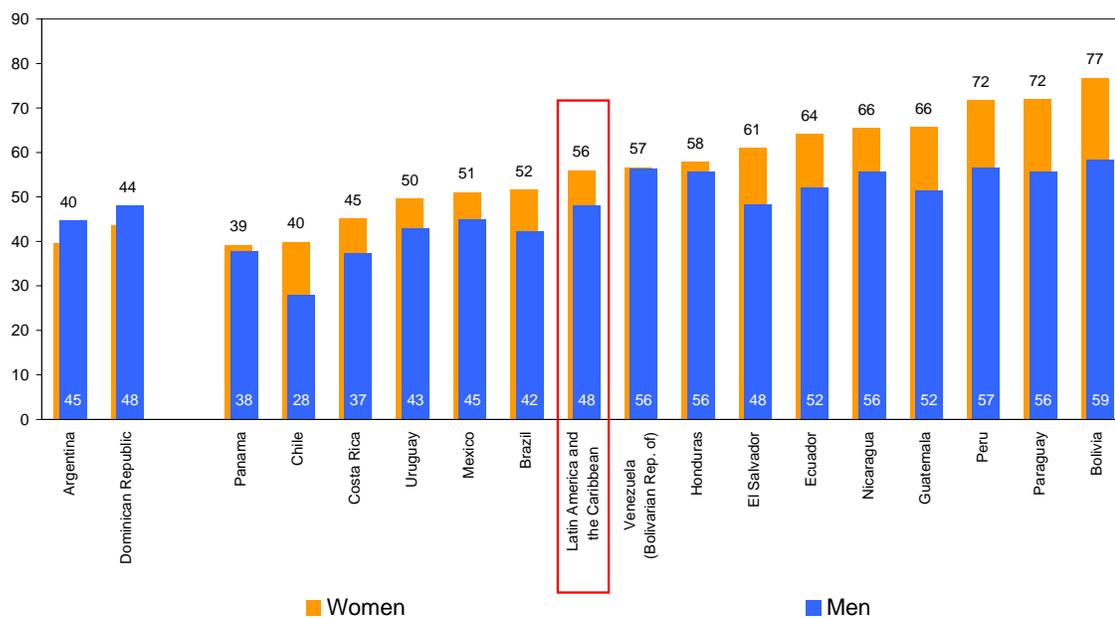
<sup>5</sup> In this respect, the prevailing gender system —characterized by social norms, laws, institutions and a lack of services and opportunities— not only means that a high percentage of women are excluded from employment, but also that those who do manage to join the labour market tend to be discriminated against.

Figure II.1  
**LATIN AMERICA AND THE CARIBBEAN: SOCIAL SECURITY CONTRIBUTORS**  
*(Percentage of the working-age population, by age and sex)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the respective countries, circa 2002.

Figure II.2  
**LATIN AMERICA (17 COUNTRIES): PERCENTAGE OF THE EMPLOYED FEMALE AND MALE URBAN POPULATION IN LOW-PRODUCTIVITY SECTORS OF THE LABOUR MARKET (CIRCA 2002)**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America, 2004* (LC/G.2295-P), Santiago, Chile. United Nations publication, Sales No. E.04.II.G.148.

## Box II.1

**MULTIVARIATE ANALYSIS OF THE PROBABILITY OF PAYING SOCIAL SECURITY CONTRIBUTIONS**

The level of employed persons' contributory coverage is to a large extent determined by their type of employment. Other factors are the place of residence, sex and other demographic factors such as age, education and marital status, which influence people's contribution status. To assess these interrelationships, microdata from household surveys were used to conduct a multivariate analysis of the determinants of contributory coverage for the employed population (see the following table).<sup>a</sup> This type of methodology makes it easier to distinguish between the effects of personal variables (sex, age, education, marital status, underage children living at home), geographical variables (urban or rural) and employment variables (size of the company, public or private sector, economic sector, professional or technical category).

The columns in table II.2 represent different models. The first column corresponds to a model in which only the non-work-related characteristics of workers and their place of residence are considered (urban or rural, where the survey makes a distinction). The second column corresponds to the model in which descriptive variables related to the type of employment are added. Given the differences observed in the disaggregated data between men and women, the third and fourth columns show the results of the second model, this time confining the sample to women only or to men only.<sup>b</sup>

First, the table indicates that demographic variables heavily influence the probability of paying social security contributions in all cases. This probability rises with age, albeit at decreasing rates, and with the level of education. It also increases if the spouse is living in the household (especially in the case of men) and is higher in urban areas.

In the first scenario of model 2, which includes a series of indicators relating to the type of employment, it can be seen that the effects of some non-employment variables diminish considerably in comparison to their levels in the first model. For instance, the effect of education on the probability of paying contributions drops by more than 40%. A similar decrease can be seen in cases where the spouse is living in the household and in urban households. This suggests that the different employment indicators tends to overshadow the influence of factors such as education, a spouse living in the household and the geographical location of households, because a significant proportion of the effect of these variables is transmitted via the labour market. For example, more highly educated individuals tend to join larger firms, in more stable economic sectors and in professional or management positions, which in turn are associated with a greater propensity to pay contributions.

The effects of employment variables shown in model 2 point in exactly the direction expected. Coverage is considerably lower in the case of own-account workers (51 percentage points less than wage earners), domestic service workers and employees in enterprises with fewer than five workers. It is also apparent that working in the public sector or as a professional or technician has a positive influence in terms of contributions.<sup>c</sup>

The sex-differentiated models yield qualitatively similar results to model 2, but show systematically higher coefficients for the age and education variables for men than for women (with respect to the base group, those under the age of 30, with fewer than six years of schooling). This reveals that the positive returns of education and experience, in terms of paying contributions, are greater among men than among women.

In short, the multivariate analysis confirms the importance of the type of employment as a determinant of the likelihood that contributions are being paid into the system, in addition to highlighting major differences between the sexes in relation to the value attributed in the labour market to education and experience.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys.

<sup>a</sup> The sample includes employed persons between the ages of 15 and 64. The dependent variable is whether or not social security contributions are made (0 or 1). Country fixed effects (which capture systematic differences in measurement methods and sampling frameworks in the different surveys) are included. Estimates are based on ordinary least squares, and standard errors are heteroscedasticity-robust and control for correlations between country errors.

<sup>b</sup> In order to check that the results are not biased by larger-population countries (Brazil and Mexico), estimates were also prepared for a model similar to model 2 but excluding these countries from the sample. The results were very similar to the ones presented here.

<sup>c</sup> The results for the indicators when they are disaggregated by sector of activity (this breakdown is not presented in the table but has been included in the estimates) show higher contribution rates for utilities (electricity, gas and water), industry and mining, finance and real estate, and commerce, with a lag in contributory coverage in agriculture and construction.

## Box II.1 (conclusion)

**LATIN AMERICA AND THE CARIBBEAN (16 COUNTRIES): REGRESSIONS OF DETERMINANTS OF SOCIAL SECURITY CONTRIBUTIONS AMONG THE EMPLOYED POPULATION**

| Independent variables   | Model 1             | Model 2             | Model 2 women only <sup>a</sup> | Model 2 men only <sup>a</sup> |
|---|---------------------|---------------------|---------------------------------|-------------------------------|
| Age between 30 and 39   | 0.082<br>(11.66)*** | 0.090<br>(15.65)*** | 0.079<br>(12.55)***             | 0.097<br>(17.50)***           |
| Age between 40 and 49   | 0.097<br>(9.03)***  | 0.116<br>(14.38)*** | 0.105<br>(8.85)***              | 0.125<br>(18.48)***           |
| Age between 50 and 59<br>[Base category: age between 18 and 29]                         | 0.094<br>(3.76)***  | 0.133<br>(16.21)*** | 0.131<br>(10.30)***             | 0.137<br>(17.73)***           |
| Education between 6 and 9 years   | 0.147<br>(6.79)***  | 0.084<br>(6.15)***  | 0.061<br>(3.22)***              | 0.096<br>(9.88)***            |
| Education between 10 and 12 years   | 0.303<br>(15.69)*** | 0.165<br>(15.52)*** | 0.144<br>(11.10)***             | 0.171<br>(19.16)***           |
| Education more than 13 years<br>[Base category: education less than six years]          | 0.465<br>(23.31)*** | 0.251<br>(13.12)*** | 0.221<br>(8.14)***              | 0.258<br>(16.73)***           |
| Head of household: woman living with spouse   | -0.003<br>(0.32)    | 0.029<br>(4.34)***  | 0.009<br>(1.89)*                |                               |
| Head of household: woman living without spouse  | 0.005<br>(0.56)     | 0.023<br>(4.54)***  |                                 |                               |
| Head of household: man living with spouse<br>[Base category: man living without spouse] | 0.053<br>(6.63)***  | 0.045<br>(4.37)***  |                                 | 0.043<br>(4.51)***            |
| Children aged between 0 and 4 present in household                                      | -0.004<br>(0.97)    | -0.004<br>(0.66)    | -0.006<br>(0.81)                | -0.001<br>(0.32)              |
| Household located in an urban area  | 0.156<br>(4.20)***  | 0.088<br>(4.16)***  | 0.062<br>(3.36)***              | 0.099<br>(4.43)***            |
| Professional or technician  |                     | 0.052<br>(3.13)***  | 0.051<br>(2.88)**               | 0.045<br>(2.49)**             |
| Domestic service worker   |                     | -0.366<br>(8.77)*** | -0.425<br>(14.08)***            | -0.186<br>(4.00)***           |
| Worker in a microenterprise<br>(fewer than five employees)                              |                     | -0.292<br>(5.54)*** | -0.310<br>(7.86)***             | -0.279<br>(4.73)***           |
| Own-account worker (or unpaid family worker)  |                     | -0.350<br>(3.22)*** | -0.417<br>(2.87)**              | -0.316<br>(3.46)***           |
| Wage earner<br>[Base category: employer]  |                     | 0.166<br>(1.97)*    | 0.176<br>(1.66)                 | 0.152<br>(2.06)*              |
| Public-sector worker  |                     | 0.079<br>(2.32)**   | 0.049<br>(1.60)                 | 0.098<br>(2.63)**             |
| Inclusion of control variables for each sector of economic activity                     | No                  | Yes                 | Yes                             | Yes                           |
| Number of observations  | 528 739             | 524 787             | 208 761                         | 316 026                       |
| Regression coefficient R <sup>2</sup>   | 0.22                | 0.41                | 0.45                            | 0.39                          |

**Note:** Robust t statistics clustered at country level are shown between parentheses. \* Significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%. All the models include country fixed effects. Countries included: Argentina, Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay. The independent variables are all “indicators” equal to zero or one.

<sup>a</sup> For “Model 2, women only”, the sample was confined to employed women; the sample for the second model, “Model 2, men only”, was confined to employed men.

Lastly, differences in contributory coverage which are due to geographical, educational, gender and labour-market factors result in marked differences in coverage, depending on the household's position in terms of income distribution. Indeed, in all the countries under study, there is a clear correlation between the household's income distribution position and the coverage rate: members of high-income households tend to exhibit systematically higher contribution and coverage rates, and there are differences of up to 60 percentage points between the first and last quintiles (see table II.2).

Table II.2  
**LATIN AMERICA AND THE CARIBBEAN: EMPLOYED PERSONS' SOCIAL SECURITY CONTRIBUTIONS, BY HOUSEHOLD INCOME QUINTILE<sup>a</sup>**

| Country   | Quintile 1<br>(lowest<br>income) | Quintile 2 | Quintile 3 | Quintile 4 | Quintile 5<br>(highest<br>income) | Q5 - Q1 |
|---|----------------------------------|------------|------------|------------|-----------------------------------|---------|
| Argentina (2002, urban areas) <sup>b</sup>                | 15.2                             | 38.3       | 57.7       | 66.4       | 76.1                              | 60.9    |
| Bolivia (2002)  | 3.2                              | 6.3        | 10.3       | 16.2       | 30.3                              | 27.1    |
| Brazil (2001)   | 20.1                             | 36.1       | 47.2       | 55.6       | 63.5                              | 43.4    |
| Chile (2003)  | 50.3                             | 60.0       | 64.5       | 68.1       | 71.4                              | 21.1    |
| Costa Rica (2002)   | 49.6                             | 58.2       | 63.7       | 66.2       | 75.1                              | 25.5    |
| Ecuador (2002, urban areas)                               | 11.1                             | 18.8       | 25.1       | 33.7       | 54.5                              | 43.4    |
| El Salvador (2001)  | 11.5                             | 16.8       | 29.5       | 36.1       | 52.9                              | 41.4    |
| Guatemala (2002)  | 4.7                              | 15.0       | 17.1       | 23.3       | 24.0                              | 19.3    |
| Mexico (2002) <sup>b</sup>                                | 28.9                             | 46.9       | 51.8       | 64.2       | 73.4                              | 44.5    |
| Nicaragua (2001)  | 6.4                              | 12.0       | 13.5       | 23.5       | 26.9                              | 20.5    |
| Panama (2002)   | 22.3                             | 42.7       | 54.8       | 61.0       | 67.0                              | 44.7    |
| Paraguay (2000)   | 3.1                              | 5.7        | 11.2       | 17.2       | 22.7                              | 19.6    |
| Peru (2001)   | 2.0                              | 5.7        | 10.1       | 15.7       | 24.9                              | 22.9    |
| Dominican Republic (2002) <sup>b</sup>                    | 34.9                             | 40.7       | 37.5       | 47.6       | 51.6                              | 16.7    |
| Uruguay (2002, urban areas)                               | 25.6                             | 48.1       | 62.7       | 75.9       | 85.3                              | 59.7    |
| Venezuela (Bolivarian Republic of)<br>(2002) <sup>b</sup> | 36.9                             | 51.9       | 59.7       | 68.1       | 78.9                              | 42.0    |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

<sup>a</sup> The definitions of coverage can be found in the notes included in table II.1.

<sup>b</sup> The rate corresponds to social security contributions from wage earners, excluding own-account workers, unpaid family workers and business owners.

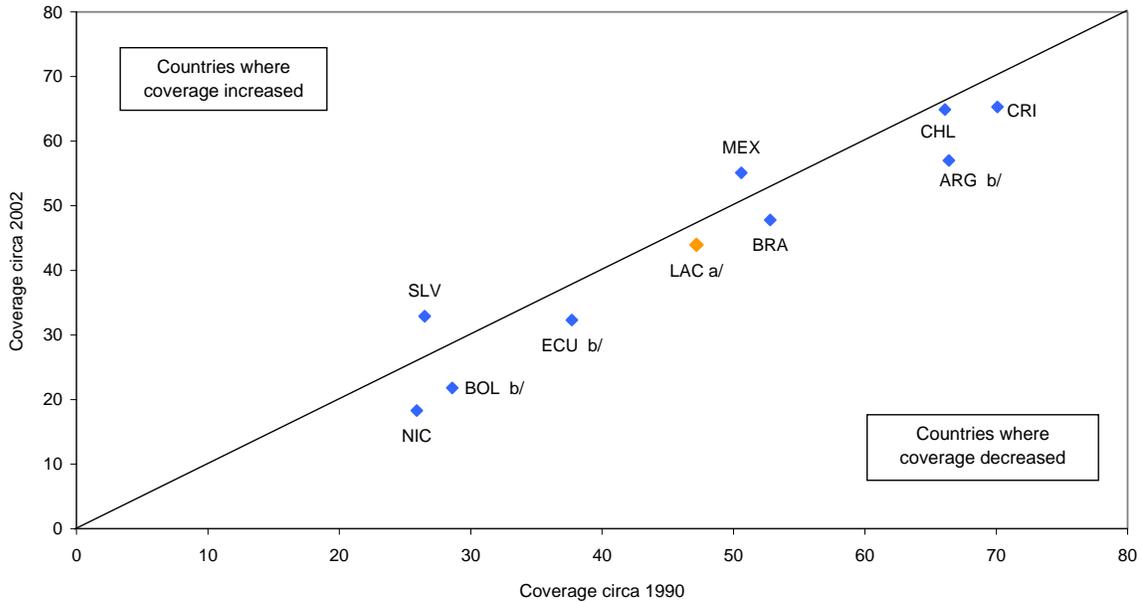
## Recent trends

Figure II.3 shows the trend in the contributory coverage of employed workers between 1990 and 2002 in nine countries of the region.<sup>6</sup> With the exception of Mexico and El Salvador, there was a drop in the proportion of employed workers paying social security contributions in all the countries under study.

As can be seen below, this trend is attributable to weak and volatile economic growth, as well as to changes in the labour market that have led to a decline in formal employment and to the precarization of the various types of jobs, which in turn have resulted in a lower level of contributory social security coverage. As figure II.4 shows, contributory coverage has declined in all dimensions of the region's labour markets, regardless of geographical location, sector (formal or informal), sex or type of employment (public-sector, private-sector or own-account).

<sup>6</sup> The choice of countries and samples was based on the availability of household surveys and comparable variables for the two periods. The countries included were Argentina (Greater Buenos Aires, 1990-2002), Bolivia (eight main cities, 1989-2002), Brazil (1990-2001), Chile (1990-2003), Costa Rica (1990-2002), Ecuador (urban areas, 1990-2002), El Salvador (1995-2001), Mexico (1989-2002), and Nicaragua (1993-2001). "LAC" represents the simple average for these nine countries.

Figure II.3  
**LATIN AMERICA (9 COUNTRIES): TRENDS IN THE COVERAGE OF THE EMPLOYED POPULATION (CIRCA 1990-2002)**

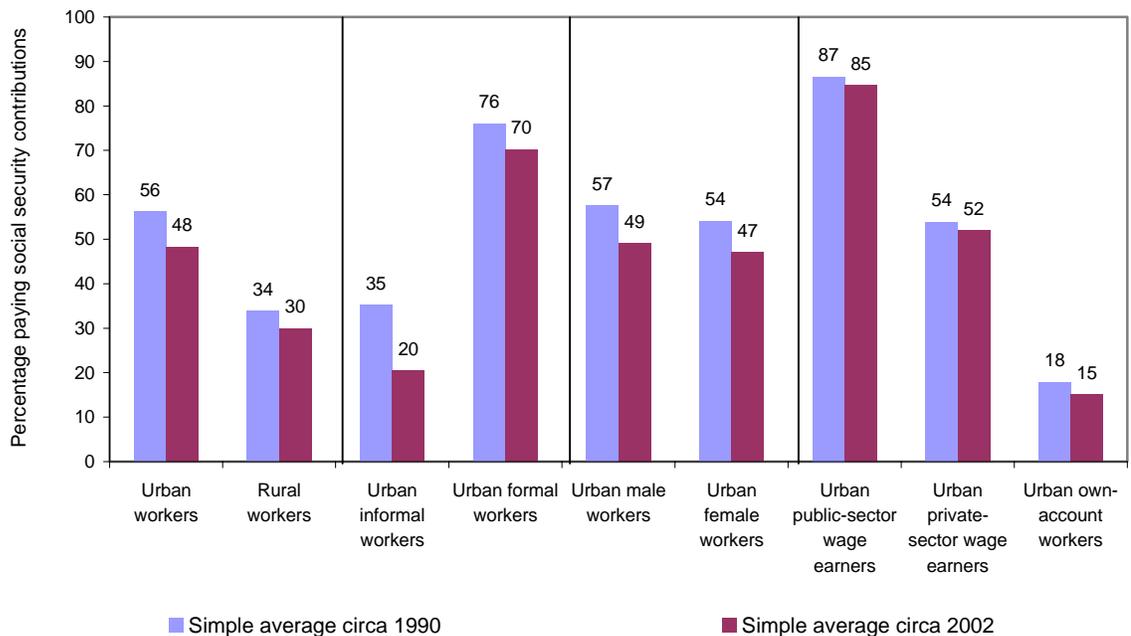


**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

<sup>a</sup> LAC = simple average for the nine countries included in the figure.

<sup>b</sup> Countries that have conducted surveys in urban areas.

Figure II.4  
**LATIN AMERICA (9 COUNTRIES): TRENDS IN THE CONTRIBUTORY COVERAGE OF SOME CATEGORIES OF THE URBAN EMPLOYED POPULATION (CIRCA 1990-2002)**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

## Labour market trends

The possibilities for extending social protection coverage by means of contributory schemes have been constrained by both the rise in unemployment rates and changes in the labour market's structure. Problems with regard to job creation are a reflection of such factors as the moderate pace and volatility of economic growth in the region. In addition, the region's employment dynamics in recent years have included greater job instability, the informalization and precarization of employment, labour-market deregulation and greater participation by women. These factors have had a negative impact on social protection coverage, as they have resulted in a shift from jobs affording higher levels of protection to less protected forms of employment.

### Economic growth, job creation and unemployment

In 2006, the Latin American and Caribbean region will complete four consecutive years of growth at an average rate of around 4%-4.5% for the period, which is a strong performance when viewed in the light of the region's record over the past 30 years. However, in addition to being below the average for developing countries as a whole, this rate is insufficient to correct the imbalances afflicting regional labour markets. Since the economically active population (EAP) is increasing at a rate of around 2.4% per year, this range of GDP growth does not leave much margin for reducing the unemployment rate, assuming some increase in productivity.<sup>7</sup>

Persistent and rising open unemployment is a new and significant trend in the region that has gained in strength since the 1990s. As shown in figure II.5, unemployment was high during the crisis that marked the first five years of the 1980s, but then began to gradually decline until the start of the 1990s. The post-1990 unemployment rate, which in most cases fluctuated between 7% and 11%, represents a major increase over the rates of around 4% recorded in 1950-1970.

The low growth rate in wage and salaried employment has had a negative effect on employment-based social protection. Even though the region's economy expanded at an average annual rate of 2.6% between 1995 and 2004, wage labour increased by just 2% per year, which is below the growth rate of the EAP (around 2.4% per year). Figure II.6 shows that, with few exceptions, own-account work increased more than wage and salaried employment.<sup>8</sup> This growth in own-account work failed to mitigate the rise in the open unemployment rate and, in addition, contributed to the expansion of informal employment, which is associated with lower social security contribution rates and, hence to a lower level of protection.

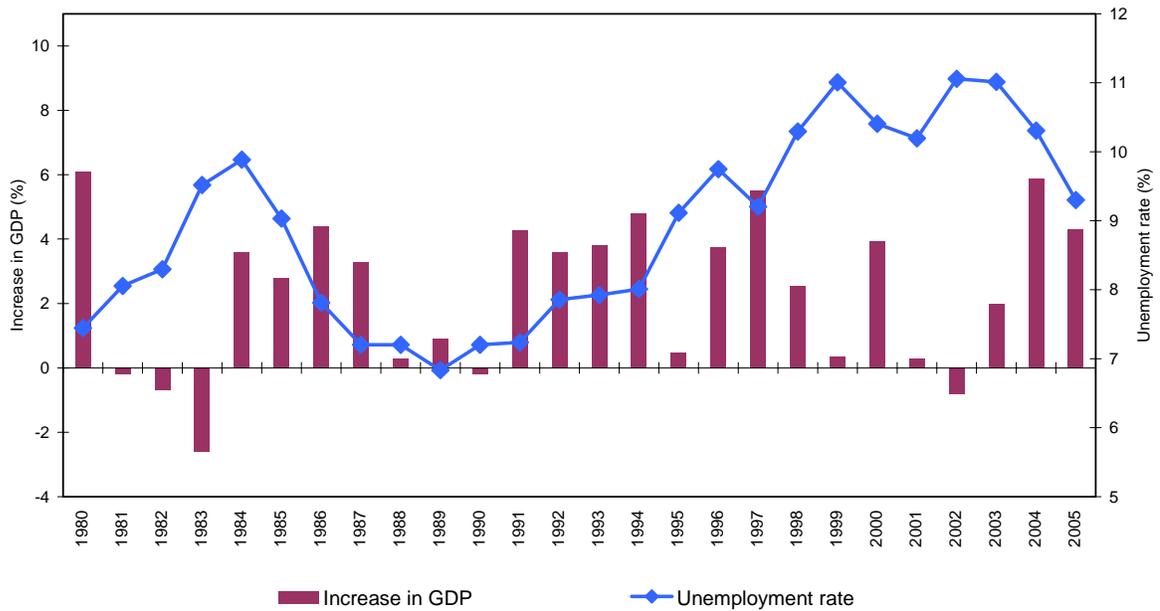
While the weakness and volatility of the region's economic growth have had a significant impact on the unemployment rate, other factors have also come into play. One such factor is that, given the greater inflexibility of real wages stemming from the existence of lower inflation rates, labour market adjustments to business cycle variations are now chiefly being made via employment levels. Some of the reforms of the 1990s facilitated this transformation of open unemployment into an adjustment mechanism, as they were designed to make employment more flexible by introducing new types of labour contracts.

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<sup>7</sup> This suggests that one of the main causes of unemployment in the region is the weak and volatile growth rate, rather than so-called "jobless growth" (ECLAC, 2005b).

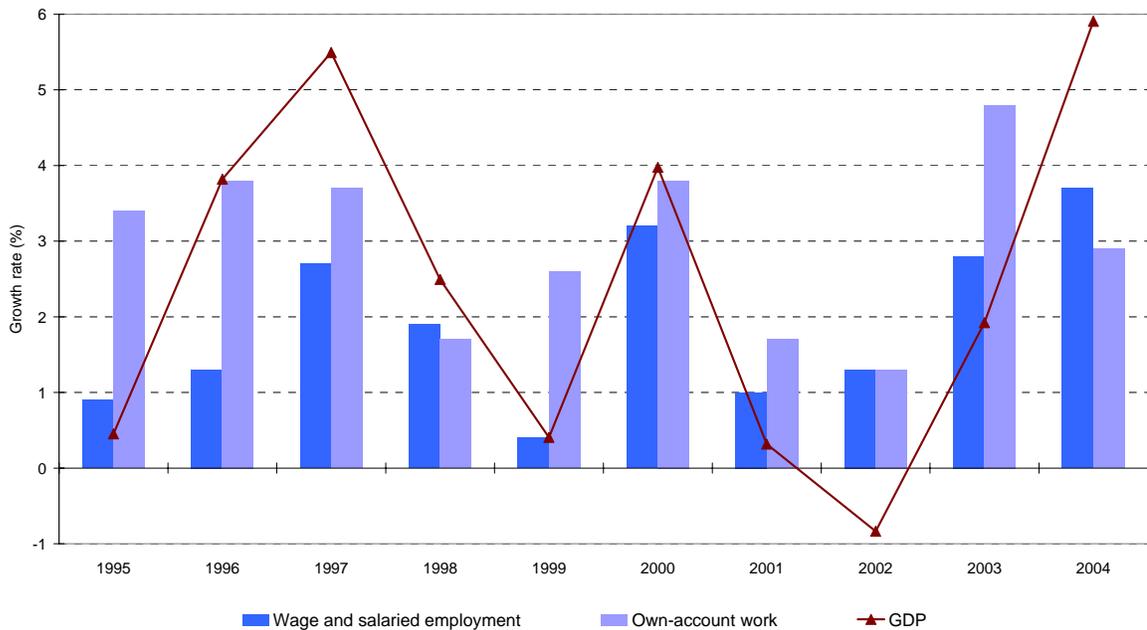
<sup>8</sup> Own-account work constitutes the largest category in the informal sector, although not all such work is informal in nature.

Figure II.5  
**LATIN AMERICA AND THE CARIBBEAN: GROWTH AND UNEMPLOYMENT**



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2004-2005* (LC/G.2279-P/E), Santiago, Chile, August 2005. United Nations publication, Sales No. E.05.II.G.2.

Figure II.6  
**LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH AND JOB CREATION DYNAMICS, BY OCCUPATIONAL CATEGORY**



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2004-2005* (LC/G.2279-P/E), Santiago, Chile, August 2005. United Nations publication, Sales No. E.05.II.G.2.

Privatization processes have also influenced the employment rate. The shift in employment from the public to the private sector initially led to a wage squeeze and, later, to job cuts.<sup>9</sup> The public sector's contribution to net job creation, which amounted to 15 out of every 100 new jobs in the 1980s, fell to 12% between 1990 and 2003. The reduction in public employment was partially responsible for the increase in unemployment and for the migration of workers to the private sector. Public employment was, and in large measure still is, characterized by contractual job security and full social protection, which partially offsets the lower pay levels found in some segments of the public sector compared to the private sector. The shift to private-sector employment has led to greater instability and less social protection, particularly for those who fail to find jobs in the larger firms (Tokman, 2005).

In addition to its negative impact on the well-being of the region's households, the drop in employment and the resulting increase in the open unemployment rate have had a negative impact on contributory social protection, since the countries of the region do not have unemployment insurance schemes capable of offsetting declines in labour earnings (see box II.2).

#### Box II.2

#### UNEMPLOYMENT INSURANCE SCHEMES IN LATIN AMERICA

Only a few Latin American countries include unemployment insurance in their social security systems: Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Ecuador, Mexico and Uruguay. The coverage of these unemployment insurance schemes is limited because they are available only to formal-sector workers.

These national systems differ from one another in terms of their financing mechanisms. Uruguay's insurance scheme is funded out of the general treasury account. The programmes of the remaining countries are financed by employers' and workers' contributions, with the exception of Argentina and Brazil, whose systems are based solely on employers' contributions. Because of the way in which the region's labour markets work, such insurance schemes usually depend heavily on government revenues, since they rarely manage to balance income and expenditure.

Coverage is limited to dependent workers, who must have made prior payments into the system. Benefits are defined as a proportion of workers' wages when they were employed.

Two reforms have been carried out in the current decade. In 2001, Ecuador introduced a programme of individual accounts which are administered by savings institutions. In 2002, Chile set up an unemployment insurance scheme under which individual savings accounts and a solidarity-based unemployment fund operate in conjunction with one another.

**Source:** M. Velásquez, "La protección frente al desempleo en América Latina", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

### Constraints stemming from labour market instability and precarization

In addition to rising levels of open unemployment and informal employment in the region, another constraint on contributory coverage is the existence of new forms of employment that have made it more precarious. Thus, the region's fairly slack pace of wage employment creation in recent years has been compounded by a decline in social security coverage for wage earners. Indeed, having paid formal employment is no guarantee that a worker will be paying into the system since, as mentioned earlier, even though coverage is much greater among formal wage earners than among informal workers, it diminished in both groups between 1990 and 2003.

The relative coverage rate for wage earners tends to drop during times of crisis, since many firms try to cut costs by replacing formal contracts with informal ones, whereas during periods of

<sup>9</sup> This shift in employment has mainly been the result of economic reforms aimed at promoting privatization in order to reduce the existing fiscal deficit and to provide incentives for private (and particularly foreign) investment.

growth, firms tend to “launder” existing jobs.<sup>10</sup> This “job laundering” may lead to such a steep rise in the number of employees registered with social security institutions and ministries of labour that the rate of increase in registration sometimes even exceeds the total job creation rate.

Many countries of the region that are seeking to boost efficiency have introduced reforms aimed at increasing labour flexibility. However, when such reforms are put into practice in a low-growth context and without foreseeing their effects in terms of labour protection, the result is that employment becomes more precarious. Two contributing factors are the adoption of atypical employment contracts and the weakening of labour inspection and supervision. Changes in labour legislation have permitted the use of a wide variety of contracts as part of an effort to allow for a gradual shift in emphasis away from indefinite contracts and towards more flexible employment arrangements. Indefinite contracts, which were the predominant pre-reform type of employment arrangement, were consistent with the idea of job stability and the penalization of dismissals. Various kinds of “promotional” contracts have been introduced, including fixed-term, temporary and part-time contracts, as well as contracts for young people, women and unemployed heads of household, to name but a few; many of these contracts do not provide for the payment of health- or pension-system contributions, or furnish only partial benefits. These new types of contracts afford less job stability and allow employers to adjust their staffing tables by dismissing workers faster and at a lower cost.

Contract diversification has been accompanied by an increase in the number of workers without labour contracts. This situation, which contravenes the legal obligations associated with the employment relationship, can be attributed to three main factors. The first is the existence of flaws in the legislation governing the establishment of responsibilities, together with shortcomings in the relevant supervisory bodies in most countries of the region. The second major factor is firms’ insufficient payment capacity. The third factor is that the increase in the number of non-contractual jobs may also reflect employers’ perceptions of the aim of the labour reforms. Indeed, the main issue of debate during the reform phase was the labour market’s rigidities, and strong signals were sent out that labour flexibility should be encouraged. In most cases, a more tolerant attitude regarding labour supervision was apparent within the context of an already weak institutional environment. Thus, whether intentionally or otherwise, the reforms and the accompanying debate conveyed a message that focused more on labour deregulation than on labour flexibility.

### Changes in family structure and the expansion of the EAP

Demographic and cultural changes as reflected in household composition are another relevant consideration. Traditionally, social security schemes were designed to protect the head of household based on the conventional model of a two-parent nuclear family. Family members were provided social security secondarily, but the person actually entitled to those rights was the head of household. Furthermore, the formal definition of dependent members was traditionally based on formal family ties. Households corresponding to the traditional nuclear family model (comprising a father, mother and children, with the wife carrying out the household duties) are no longer in the majority in Latin America, however (ECLAC, 2003a and Arriagada, 2004). In 2002, this definition applied to just 36% of all families, and that number had already dropped by 10 percentage points during the 1990s. Recent trends in the region indicate that the proportion of formal families is diminishing as a result of decreasing marriage rates and increases in the number of consensual unions,<sup>11</sup> divorces and annulments and in the mean age at first marriage. These changes point to a

<sup>10</sup> As an annual average, in 2004 the number of wage earners contributing to social security systems increased by 10.5% in Argentina, 5.1% in Brazil and 7.0% in Nicaragua. During the first nine months of 2005, it rose by 5.2% in Costa Rica and 7.4% in Chile (ECLAC, 2005b and 2005c).

<sup>11</sup> In Argentina, for example, the percentage of consensual unions increased from 7% to 18% between 1960 and 1991. In the city of Buenos Aires the rise was even greater: from 1.5% of unions in 1960 to 21% in 2001. In Brazil, consensual unions increased from 18% to 28.3% between 1991 and 2000, and in Chile, from 6.3% to 16.1% between 1982 and 2002 (IBGE, 2004; Rodríguez Vignoli, 2004; Jelin, 2005).

need to redefine the basis for recognition of dependent status, since dependents' entitlement to such rights are at present determined largely by the existence of formal family ties. Changes in social protection policies and in family legislation are thus called for (Rodríguez Vignoli, 2005b).<sup>12</sup>

In addition to these changes in family structure, women's participation in the region's labour force is growing. Between 1990 and 2002, the female participation rate in urban areas of Latin America increased from 37.9% to 49.7% (ECLAC, 2004a). Even though the gap between the female and male participation rate narrowed, there continues to be a differential of 30 percentage points. The female participation rate is also much lower in poor households than in others. In 2002, 55% of women from the region's non-poor households were working, but the corresponding percentage for poor households was 43%. Women have a higher unemployment rate than men and, when they do secure jobs, their pay rates are, on average, 35% lower. This also means that their pensions are smaller than men's after the age of 65 (77% of the average level for men). In spite of these differences, women's contribution to total household income, especially in poor households, diminishes the impact of poverty significantly. On average, their contribution reduces the overall poverty rate by around 10 percentage points (ECLAC, 2004a).<sup>13</sup>

Another trend to have emerged in recent years has to do with the qualitative shortcomings associated with many young people's integration into the workforce, which is reflected in high open unemployment rates, high informal employment rates and insecure or substandard contractual conditions. This not only affects young people's current and future well-being, but also limits their parents' ability to save for their own old age, as they have to continue maintaining their children for extended periods of time.

### **Policy guidelines for increasing contributory coverage in the labour market**

In order to increase contributory coverage, a systemic modification will have to be made in the labour/social protection equation. For the reasons explained, although sustained growth in the region's economies and better integration into the employment and production systems are prerequisites for improving social protection, they are not enough in themselves. Similarly, policies confined to rectifying flaws in the social protection system will be insufficient, as long as job instability and precarious employment conditions continue to predominate in the labour market and to hinder job creation. A series of challenges that have arisen within the arena of labour policy are described below. These challenges must be tackled in order to increase contributory coverage by promoting decent work, implementing active labour-market policy measures and striving to increase the formal sector of the workforce.

Labour demand can be stimulated by means of macroeconomic, horizontal, sectoral and territorial policies and, most importantly, policies designed to expand employment via specific programmes and to encourage private-sector hiring. Aside from macroeconomic policies aimed at safeguarding employment levels and dampening its volatility over the long term, policies for productive development can boost employment demand indirectly by improving the way in which the production apparatus operates (ECLAC, 2004b). Particularly effective tools in this regard include policies for improving the position of small and medium-sized enterprises, promoting the regional development of certain types of production clusters and providing incentives for labour-intensive activities such as tourism and low-cost housing construction.

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<sup>12</sup> As Jelin (2005) points out, social expectations regarding the duties and responsibilities arising from these new ties are changing. It is not a question of legislating on love and affection, but of establishing a few parameters to incorporate these ties as a way of defining lines of responsibilities for the protection of people in vulnerable positions.

<sup>13</sup> In some cases, the effects are even greater. In Uruguay, the contribution from wives reduces the poverty rate from 30% to 10% (ECLAC, 2004a).

Productive job creation policies entail the development of new forms or aspects of labour adaptability in order to adjust the labour market to new conditions arising within the production structure (see box II.3). This will help to boost employment growth further and to reduce unemployment by shortening the necessary adjustment period. However, flexible employment contracts must never disregard the need to provide full social protection or be confused with market deregulation. They must also be compatible with investment incentives for innovation and training as a means of raising productivity.

### Box II.3

#### MEASURES FOR PROMOTING STABLE AND COMPETITIVE EMPLOYMENT

1. Reorienting policies for enhancing labour flexibility. The use of unconventional contracts should be subject to certain limits, and efforts should be focused on broadening opportunities for the introduction of more flexible long-term contracts.<sup>a</sup> The overuse of flexibility measures has exacted heavy economic and social costs, since it has eroded long-term contracts and introduced an unnecessary degree of job instability and a lack of employment protection. Both of these factors have an adverse effect on workers and reduce incentives for learning, innovation and higher productivity.
2. Introducing flexibility by combining a reduction in the cost of dismissing workers with transferral of protection from jobs to workers. This would facilitate the transfer of protection and cumulative entitlements when workers change jobs, even when it is on their own volition.<sup>b</sup>
3. Making working hours more flexible. Without changing the number of hours to be worked as specified in the applicable labour codes, working hours could be spread out over a longer period of time. This would allow working hours to be geared to companies' requirements, thereby reducing costs and raising productivity.
4. Making wages more flexible at the microeconomic level. Wages can be linked to productivity gains or company profits. This could have a dual effect: first, it could allow part of the adjustment to reductions in demand to be passed onto wages, thereby mitigating the impact of such contractions on employment levels; and second, it would provide incentives for boosting productivity.
5. Developing a new collective bargaining agenda. Up to now, given the inflationary history of Latin American countries, this agenda has focused on wage demands. For well-founded reasons, the main priority of trade unions has been to recoup and increase wage levels, but this tends to fuel conflict and fails to create the conditions required to gradually consolidate factors that play an important role in modernizing production, such as higher productivity and profit-sharing. Incorporating issues such as training and higher productivity into the collective bargaining agenda would permit a more appropriate use of available resources and would take into consideration workers' preferences and their accumulated knowledge.
6. Focusing on the situation of more vulnerable groups and on the new distribution of roles within the family. Contracts providing for flexible working hours are a good way to combine work with other activities, such as schooling, childcare or elder care. Steps should be taken to foster the use of employment contracts that provide for some flexibility in working hours by spreading out or allotting working hours or days, establishing special working hours, defining agreed time frames for vacations and for holiday working hours or by other means.

**Source:** Víctor Tokman, "Inserción laboral, mercados de trabajo y protección social", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), December 2005, unpublished.

<sup>a</sup> This has happened in countries such as Spain, which pioneered labour flexibility by introducing unconventional employment contracts in 1981 and then adopted a counter-reform in 1997 that makes their use subject to collective bargaining.

<sup>b</sup> Countries that have made such compensatory benefits more available are Peru, Colombia, Panama and Brazil, where such funds were converted into deposits in the worker's name, instead of being held on the books as corporate liabilities.

In addition, the aim of active labour market policies is to get people back to work as soon as possible and thus mitigate the effects of unemployment and job instability. Such policies have become more important over the past decade, when so many major changes took place, especially in terms of vocational training, intermediation and direct employment programmes (Weller, 2004).

Noteworthy innovations in the field of vocational training include trainer diversification, the increased involvement of private institutions and the concentration of the financing and regulation of training in the public sector.<sup>14</sup> Efforts are also being pursued to make vocational training

<sup>14</sup> See Gallart (2001) and Labarca (2003) regarding recent changes in vocational training.

activities more demand-led, in many cases by means of inservice training for skilled staff who play a key role in keeping their companies competitive. Specialized vocational training programmes have also been developed for unemployed groups with specific problems, including poorly-educated young people and women, and workers in low-productivity, low-wage jobs (such as own-account workers and microentrepreneurs).

In addition, there is now a renewed appreciation of intermediation as a potentially effective and low-cost instrument. Major efforts have been made to extend its coverage by incorporating new technology and setting up various forms of public/private cooperation. To take fuller advantage of its potential, steps have been taken to integrate intermediation more extensively with active and, where appropriate, passive policies too (see box II.4 and Mazza, 2003). Rising unemployment in the late 1990s also reawakened interest in direct job creation programmes. Hiring subsidies are another innovative concept that has been implemented in the region, but so far to only a limited extent.<sup>15</sup>

#### Box II.4

### INTERACTION OF PASSIVE AND ACTIVE LABOUR POLICIES: DENMARK'S SUCCESS STORY

A clear example of the link between active and passive policies is Denmark's unemployment benefit system. All workers belonging to the unemployment insurance system are entitled to receive benefits equivalent to 90% of their prior income for a maximum period of four years, including periods of renewed employment. In the case of low-income workers, the insurance is combined with other government transfers to provide a 90% replacement rate. In order to offset the possible employment disincentives of this high replacement rate, the system requires unemployed people to actively seek jobs and to return to full-time work after six months' unemployment in the case of those under the age of 25 and after 12 months for people over that age. Between 1979 and 1993, this scheme was supplemented with active supply-side labour policies, training, and support for the creation of own-account forms of work. The poor outcomes of these policies led to a general reform starting in early 1994.

This reform involved redefining active policies and gradually reducing the term of the insurance. A two-period benefit system was introduced, with an initial passive four-year period followed by a three-year "activation" period. The basis for benefit allocation was also switched from unemployed status to means-testing. In addition, the management of the insurance scheme was decentralized to tripartite regional councils, which were given the necessary flexibility to adapt the insurance scheme to local requirements. The training component was eliminated, for which a supplementary allowance had been added to the unemployment benefit. In addition, three types of leave - for childcare, education and a sabbatical year - were introduced, with a salary proportional to the unemployment benefit, in order to promote job rotation. The term of the insurance was gradually reduced, from four years in 1994 to two in 1996, and finally to one in 1999, while the term for persons under 25 years of age was reduced to six months. In 2000, these measures enabled Denmark to comply with the European Union's first two employment guidelines, which are oriented towards a rapid return to work for unemployed youths and adults.

Even after introducing these changes, Denmark is still the country that spends the largest proportion of its GDP on labour policies —4.5% of GDP (including 3% for passive policies). It is noteworthy that the drop in the unemployment rate from 10.2% in 1993 to 5.2% in 1999 coincided with the reform period.

**Source:** P.K. Madsen, "The Danish model of flexicurity: A paradise - with some snakes", *Labor Market and Social Protection Reforms in International Perspective: Parallel or Converging Tracks?*, H. Sarfati and G. Bonori (eds.), Ashgate, 2002; and "Security and flexibility: friends or foes? Some observations from the case of Denmark", *The Future of Work, Employment and Social Protection. The Dynamics of Change and the Protection of Workers*, Peter Auer and Bernard Gazier (eds.), Geneva, International Labour Organization (ILO), 2002.

In addition to employment promotion and active policies, the specific issue of the informal sector must be addressed as part of a systemic strategy for improving the employment/social protection equation. Policy stances on the region's informal sector have alternated between ignoring it, persecuting it or "laundering" informal employment, depending on government policy and on how powerful the groups that might be hurt by competition from it are. Such policies are only partial solutions to a larger problem, which is to facilitate the transition from informal to modern employment.

<sup>15</sup> Chapter V examines emergency employment programmes in greater detail.

Informal enterprises operate outside the regulatory sphere in order to evade costs, but this also means that they are missing the opportunity to play a full part in the modernization process. As a result of the use of strategies for minimizing possible sanctions for infringing laws and regulations, their exclusion is not absolute, but it does lead to a form of semi-integration.

An important consideration is that, in many instances, regulations have been designed for large enterprises and well-organized sectors. One suggestion might be to gear employment formalization requirements to informal workers' compliance ability; this should not entail the adoption of a dual system, but rather the adaptation of the existing regulatory framework and a dynamic convergence towards full compliance (see box II.5).

#### Box II.5

#### ELEMENTS OF A STRATEGY FOR FORMALIZING THE LABOUR MARKET

1. Agreeing upon a unified normative framework that takes into account the inherent differences in informal workers' ability to comply fully with such standards. Lapses in compliance are tolerated while promoting progress towards full implementation.
  2. Adapting formalization requirements to the situation of informal workers. Such modifications usually relate to the cost of compliance with existing standards and to formalization procedures and mechanisms. Simplifying procedures also breaks down access barriers. Many countries are adopting simplified registration systems and are reducing and consolidating formalities and procedures in order to cut down on costs and delays.
  3. Reorienting formalization mechanisms. Essentially, the focus here is on facilitating the recognition of formal status before requiring compliance with its associated obligations. This may entail the recognition of businesses' assets and legal status for commercial, employment, tax and other purposes.
- These guidelines point to a different way of looking at formalization, whereby it becomes an instrument for helping to incorporate informal workers into the modernization process. Under this approach, the rationale for formalization ceases to derive from the interests of organized sectors and is instead based on the potential benefits that formal status can provide in terms of business development and for workers in the informal sector.

**Source:** Víctor Tokman, "Inserción laboral, mercados de trabajo y protección social", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), December 2005, unpublished.

Rights must be assigned the same crucial importance as is now given to obligations with a view to creating virtuous circles by extending the coverage of the regulatory framework in order to enable citizens to comply with their obligations and at the same time to benefit. This would allow the formalization of employment to be tied in with the contributory social protection system, which may provide the necessary incentive to prompt informal workers themselves to take the lead in efforts to formalize and modify their employment status. However, if voluntaristic approaches are to be avoided, it has to be acknowledged that this will be a lengthy and sometimes difficult reform process.

### Summary

Trends in the labour market have not facilitated the expansion of social protection coverage. In fact, as figure II.3 shows, contributory coverage in the region shrank between 1990 and 2003. Factors underlying this decline included higher unemployment, slack growth in wage and salaried employment, rising informal employment and the precarization of the labour market. The increasing precariousness of employment is reflected in the fact that being a wage earner no longer, in itself, guarantees coverage under a contributory social security system.

So, while faster growth is essential in order to boost workers' contributory capacity and energize the labour market, it is not a sufficient condition for achieving these objectives and must therefore be supplemented by labour policies to promote social protection. It is also important to ensure that adaptive labour policies do not conflict with social protection coverage. To move in this direction, workers must be given guaranteed social coverage, have access to unemployment insurance and be assisted to re-enter the workforce. Training programmes focusing on innovative

learning processes need to be promoted to facilitate a rapid adjustment to changes in labour market demand, and steps should be taken to limit the use of unconventional contracts, develop unemployment insurance systems that include solidarity-based public financing mechanisms whose use should be conditional upon the recipients' efforts to seek out training and job opportunities, and formulate employment and family policies that reconcile men's and women's work in the home with access to social protection (ECLAC, 2004a).

In spite of the efforts being made in this area, there is unlikely to be a reversal in the situation in the short to medium term. It is therefore urgent to work towards the development of social protection systems that are not necessarily employment-based. This calls for an analysis of the fiscal viability of implementing government-funded social protection mechanisms. The following sections of this chapter offer just such an analysis.

## Trends and prospects for public social protection expenditure

As noted earlier in this chapter, progress in providing broader contributory benefit coverage has come to a standstill in the region, and there is no sign of a reversal in this process in the short term. This makes policies for extending the coverage of non-contributory schemes particularly important. Financing such programmes will require a major effort to increase social expenditure. A few of the most notable features of social expenditure in the region are examined below, in particular its level, trend, structure and vulnerability. It is important to note that not all the countries in the region will respond in the same way to demands for increased social expenditure. Whereas some countries will centre their measures for improving social security coverage on the composition of public expenditure, others will link the measures they take more closely with policies to increase fiscal revenues.

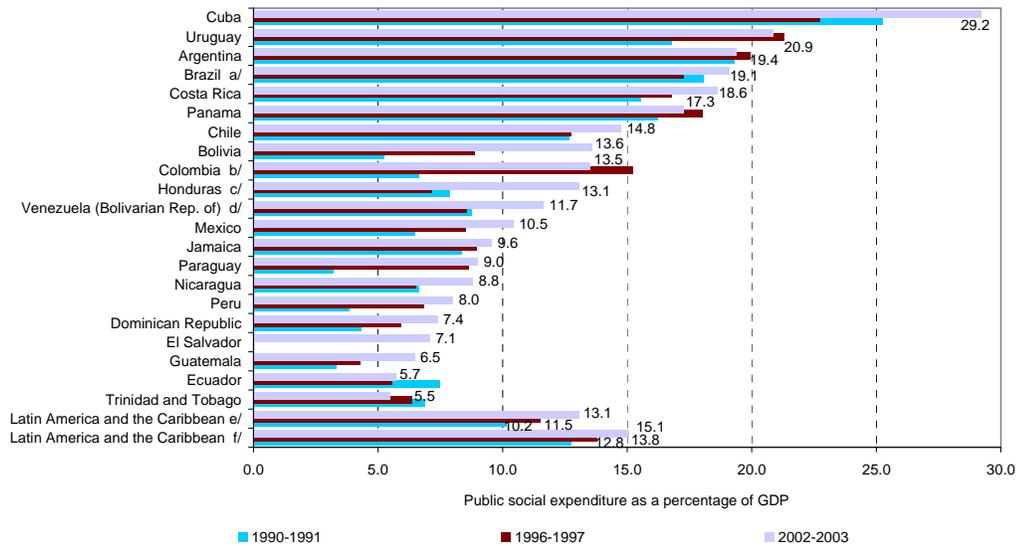
### Structure and dynamics of social expenditure

The level of public social expenditure in the countries of the region varies widely but has, in any event, risen sharply over the past 15 years. As shown in figure II.7, there was a widespread increase in social expenditure as a percentage of GDP during the first half of the 1990s. Although the trend varied from one country to another in the second half of the 1990s, social expenditure has tended to climb in most countries during the early years of this century, rising to a weighted average of nearly 15% of GDP.

The level of social expenditure is not the only relevant consideration. Its composition is also important. Increases in expenditure must reflect the needs of each society, rather than budget inertia or pressure from interest groups. As figure II.8 shows, the upward trend in public social expenditure in the region seen over the past 15 years is largely attributable to the growth of expenditure on social security, social assistance and education.

In terms of its distributive effect, social expenditure has had a positive impact on the incomes of the poorest households (see figure II.9). Social expenditure raised total primary household income by 17%, and in the poorest quintile the increase amounted to 86%. In proportional terms, social expenditure's contribution to the poorest households' incomes is five times greater than its contribution to all households, taken as a group, and ten times as much as it is for the top quintile. This ratio between the contributions made to the primary incomes of people in the top and bottom strata is more or less homogeneous in all the countries considered.

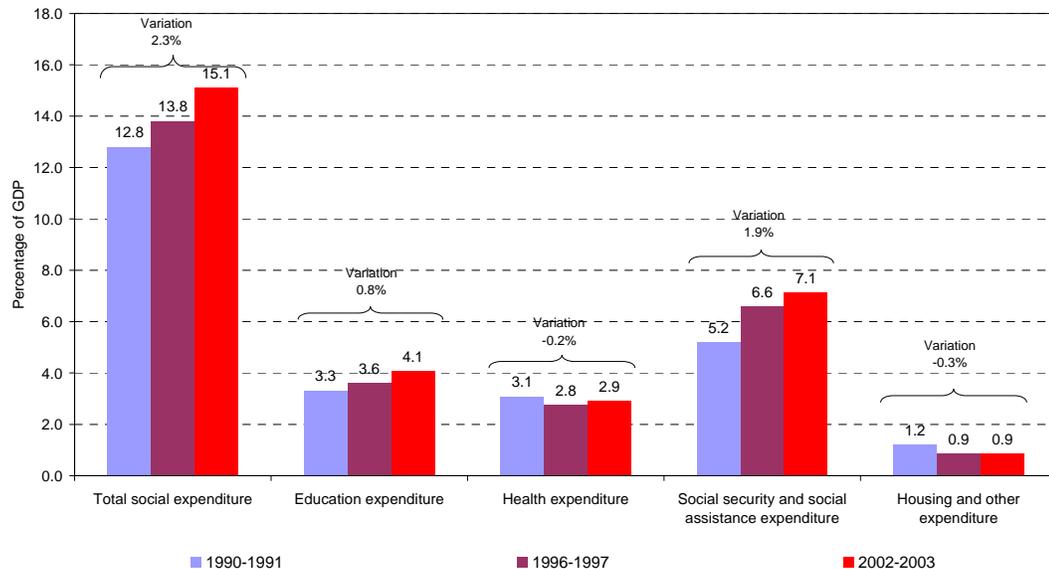
Figure II.7  
**LATIN AMERICA AND THE CARIBBEAN (21 COUNTRIES): SOCIAL EXPENDITURE, 1990-1991, 1996-1997 AND 2002-2003**  
*(Percentages of GDP)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Commission's social expenditure database. Figures have been updated to the second quarter of 2005.

- <sup>a</sup> Figures for 2002-2003 correspond to an estimate of social expenditure at the three levels (federal, state and municipal) of government based on information on federal social expenditure. <sup>b</sup> Figures for 2002-2003 correspond to the mean for 2000-2001 and are not included in the averages. <sup>c</sup> Figures for 2002-2003 correspond to 2004 and are not included in the averages. <sup>d</sup> Figures for the Bolivarian Republic of Venezuela correspond to agreed social expenditure levels (budgeted levels plus the effects of budgetary amendments as of the end of each year). <sup>e</sup> Simple average for the countries, with the exception of El Salvador. <sup>f</sup> Weighted average for the countries, with the exception of El Salvador.

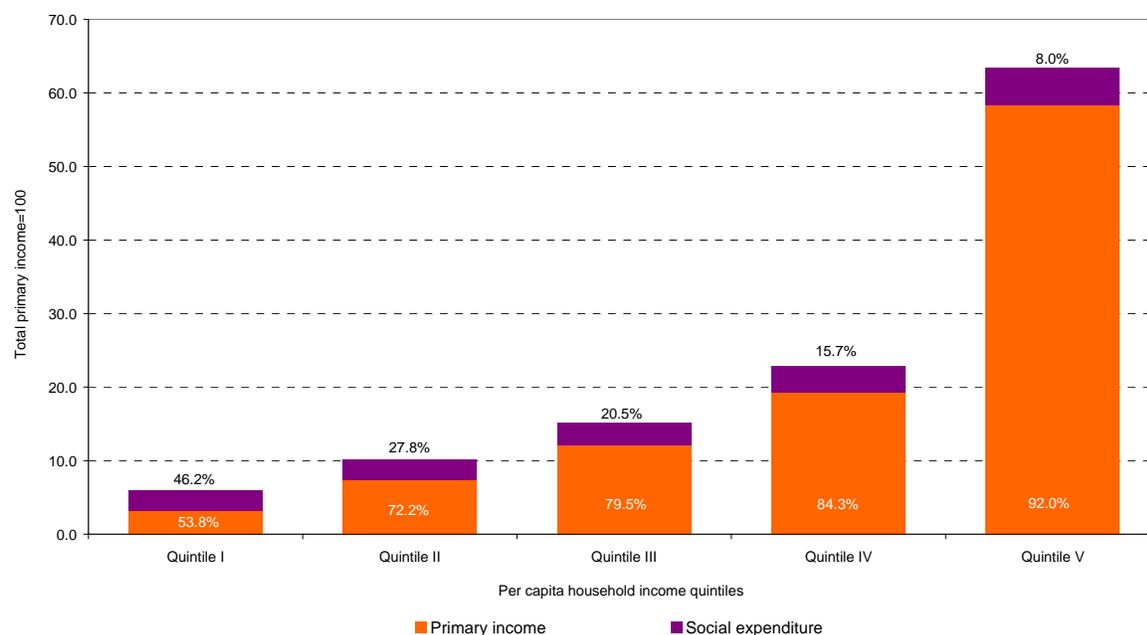
Figure II.8  
**LATIN AMERICA AND THE CARIBBEAN: SOCIAL EXPENDITURE, BY SECTOR, 1990-1991, 1996-1997 AND 2002-2003<sup>a</sup>**  
*(Percentages of GDP)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Commission's social expenditure database. Figures have been updated to the second quarter of 2005.

- <sup>a</sup> GDP-weighted average for the countries based on data on social expenditure, with the exception of El Salvador. Percentages do not necessarily add up to the totals shown due to rounding.

Figure II.9  
**LATIN AMERICA (SIMPLE AVERAGE FOR 9 COUNTRIES): EFFECT OF SOCIAL EXPENDITURE IN INCREASING PRIMARY INCOMES IN EACH PER CAPITA HOUSEHOLD INCOME QUINTILE<sup>a</sup>**  
*(Total primary income = 100, and percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of country studies furnished by the Inter-American Development Bank. Simple average for nine Latin American countries.

<sup>a</sup> Does not include expenditure on housing, water or sewerage services.

With respect to the intergenerational redistributive effects of the different items of social expenditure, it has been found that, owing to the differences in the age distribution of programme beneficiaries, public transfers are not always highly redistributive and tend to favour some generational groups over others. In many cases, they have a much stronger poverty-reduction effect among older adults than among children (as has been seen in Brazil, El Salvador and Mexico) and, in fact, the share of the total poor population that is represented by children has stayed constant or even increased in a number of countries in the region (Uthoff and others, 2005).<sup>16</sup>

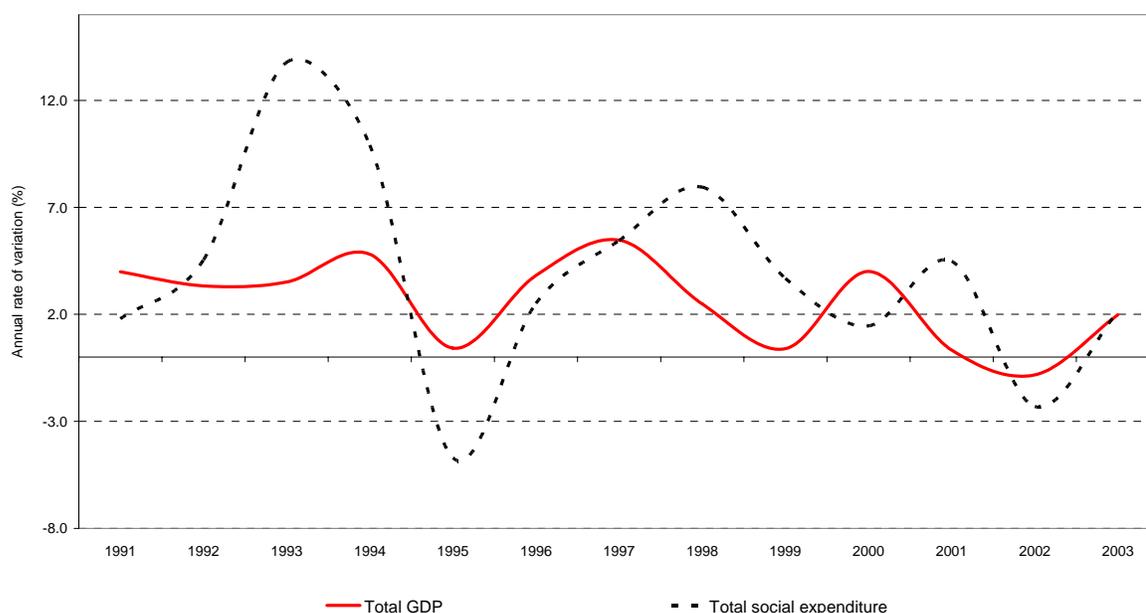
### The social expenditure cycle, vulnerability and priorities

There is a certain degree of consensus that, in the recent past, Latin America's fiscal policies have been procyclical (see figure II.10).<sup>17</sup> To reverse this situation, countries need to take advantage of periods of economic growth to set up or strengthen mechanisms for ensuring the intertemporal consistency of public expenditure. In particular, it is necessary to reduce the vulnerability of social expenditure, since it is more procyclical than other items of public expenditure in the region (see box II.6). Past events have demonstrated, however, that it is exceedingly difficult to achieve a priority status for social expenditure.

<sup>16</sup> The redistributive effect of private transfers is progressive in some cases. For instance, in countries such as El Salvador and Mexico, these transfers tend to benefit lower-income people. In other cases, however, they appear to benefit those who are already relatively better off, leading to a generational reproduction of poverty and wealth (Uthoff and others, 2005).

<sup>17</sup> For a recent analysis of the situation, see Martner and Tromben (2004), among others.

Figure II.10  
**LATIN AMERICA AND THE CARIBBEAN (20 COUNTRIES): TRENDS IN GDP  
 AND SOCIAL EXPENDITURE**  
*(Annual rates of variation)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2004-2005* (LC/G.2279-P/E), Santiago, Chile, August 2005. United Nations publication, Sales No. E.05.II.G.2.

Even though the fiscal responsibility laws approved during the past decade have certainly stemmed the growth of national debt levels in some cases, few countries have explicitly set out to make their macrofiscal rules countercyclical.<sup>18</sup> An interesting example of countercyclical fiscal policy is the structural surplus rule applied by Chile in recent years, according to which any increases in public expenditure are determined on the basis of trend GDP, regardless of fluctuations in actual GDP. This ensures a stable and neutral trend in expenditure, at least in theory, while also reducing the likelihood of sudden corrections and, in practice, conferring a degree of certainty on the pluriannual implementation of public projects and programmes.<sup>19</sup>

<sup>18</sup> The legislative limitations placed on public expenditure increases (3.5% per year in real terms in Ecuador and Peru, for example) tend to result in a decline in expenditure, measured as a percentage of GDP, if the economy's trend growth rate is higher than the established figure; these limitations can therefore not accurately be described as intertemporally neutral. In the case of Chile, the countercyclical policies of the 1990s, which combined high growth rates with sharp reductions in national debt, led to the creation of a "social dividend", where social expenditure increases are inversely proportional to the reduction in interest payments for long periods of time.

<sup>19</sup> Stabilization funds for fiscal revenues (Peru) or raw materials (Bolivarian Republic of Venezuela, Chile, Ecuador and Mexico) are in fact explicitly countercyclical policies. In Peru, any resources in excess of 2% of GDP in the Fiscal Stabilization Fund (the public sector's fiscal surplus at the end of the financial year) are used to pay off debt. In Ecuador, 70% of the resources in the petroleum stabilization fund were used to buy back debt and to pay off liabilities with the Social Security Institute. In Chile, windfall profits from copper sales are paid into the Compensation Fund, whose only purposes are to accumulate reserves and make early payments on the country's external debt (for further details, see ILPES, 2004, and Jiménez and Tromben, 2005).

Box II.6  
**VOLATILITY OF PUBLIC SOCIAL EXPENDITURE**

Using different methods, Hicks and Wodon (2001) and ECLAC (2005b) have presented information on the procyclical behaviour of public social expenditure in the region. The results of an econometric exercise conducted to estimate the GDP elasticity of total public expenditure and of social expenditure, in particular, are described below. The first column shows that the simple average elasticity for social expenditure in Latin America and the Caribbean is 1.87, which signifies that it is highly procyclical. This is not the case in all the countries, however. In effect, the value of the coefficient appears to depend on the situation at the starting point, with elasticity being greater in countries whose social expenditure was lower in the early 1990s, such as Bolivia, Colombia, Guatemala, Mexico, Paraguay and Peru. This may explain the lower elasticity observed in Argentina, Brazil and Chile, whose initial levels of social expenditure were higher.

The third column compares the estimated elasticity of social spending and of total public expenditure. A value higher than 1 indicates that social expenditure has behaved more procyclically than the rest of public expenditure. This is the case in virtually all the countries, with the exception of El Salvador, although the indicator is significant in only a few cases (Bolivia, Brazil, Guatemala, Honduras and Peru). In these countries, social spending has risen much more than total expenditure during boom periods and has decreased much more in times of recession.

**ELASTICITY OF PUBLIC EXPENDITURE IN RELATION TO GDP IN SELECTED COUNTRIES**

|                                    | Elasticity of social<br>expenditure<br>(1) | Elasticity of total<br>expenditure<br>(1) | Ratio<br>(1/2)    | Number of<br>observations |
|------------------------------------|--|---|-------------------|---------------------------|
| Argentina                          | 0.91                                       | 0.82                                      | 1.11              | 15                        |
| Bolivia                            | 2.95                                       | 1.90                                      | 1.55 <sup>a</sup> | 15                        |
| Brazil                             | 1.56                                       | 1.16                                      | 1.34 <sup>a</sup> | 15                        |
| Chile                              | 0.93                                       | 0.73                                      | 1.27              | 25                        |
| Colombia                           | 2.12                                       | 2.02                                      | 1.05              | 22                        |
| El Salvador                        | 1.57                                       | 1.99                                      | 0.79              | 9                         |
| Guatemala                          | 1.84                                       | 0.99                                      | 1.86 <sup>a</sup> | 25                        |
| Honduras                           | 1.56                                       | 0.97                                      | 1.61 <sup>a</sup> | 21                        |
| Mexico                             | 1.78                                       | 1.58                                      | 1.13              | 15                        |
| Paraguay                           | 3.31                                       | 3.17                                      | 1.05              | 25                        |
| Peru                               | 2.41                                       | 1.02                                      | 2.36 <sup>a</sup> | 15                        |
| Dominican Republic                 | 1.60                                       | 1.46                                      | 1.10              | 25                        |
| Uruguay                            | 1.82                                       | 1.64                                      | 1.11              | 15                        |
| Venezuela (Bolivarian Republic of) | <sup>b</sup>                               | <sup>b</sup>                              | -                 | 25                        |
| Latin America                      | 1.87                                       | 1.50                                      | 1.38              |                           |

**Source:** Eduardo Aldunate and R. Martner, "Política fiscal y protección social", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished, on the basis of information from the Commission's social expenditure database.

**Note:** These estimates were calculated using the following equation:  $\text{Log } G_i = \alpha \text{ Log } G_{i-1} + \beta \text{ Log } \text{GDP}_i + \gamma$ , where  $G$  corresponds to total or social expenditure, and  $\text{GDP}$  corresponds to the gross domestic product of each country  $i$ , with both variables measured in constant terms. The elasticities shown are long-term  $\beta/(1-\alpha)$ .

<sup>a</sup> Statistically significant coefficient.

<sup>b</sup> Not statistically significant.

While it is obviously important to allocate resources to social protection, this effort should not overshadow other categories that also make a key contribution to economic and social development.<sup>20</sup> The region has used a variety of tools for redeploying public expenditure on social sectors, including legislative and operational rules designed to give priority to social expenditure

<sup>20</sup> International organizations have made tremendous efforts to promote pro-poor budgets. A few decades ago, development objectives were generally envisaged in terms of growth and equity, while in recent years, priority has been given to reducing poverty. In this respect, the Heavily Indebted Poor Countries (HIPC) Initiative provided a unique opportunity to redirect savings on interest realized from external debt reductions to social expenditure. As part of the associated conditionality, donors encouraged beneficiary countries to define their expenditure priorities. According to a World Bank study (2003), in a total of 26 countries, 65% of available resources were earmarked for social expenditure, especially education and health. The remainder was allocated to agriculture, social safety nets, infrastructure, governance and other measures.

objectives (see box II.7) and the development of a medium-term (pluriannual) public expenditure framework for facilitating the necessary reallocations between categories (Schick, 2002; Blöndal, 2005). In fact, the countries of the Organisation for Economic Co-operation and Development (OECD) have used this instrument to place priority on investments in education and increases in total productivity (European Commission, 2004).

#### Box II.7

#### PRIORITIZING SOCIAL EXPENDITURE

Article 350 of Colombia's 1990 Constitution provides that public social expenditure shall have priority over any other appropriation and that social expenditure should be increased from year to year. The final clause of the first section of the definition set forth in Act No. 179 of 1994 includes, in addition to specific activities, those conducive to the general well-being and the improvement of the population's standard of living. The problem is that these provisions are often rules in word only because they apply to all categories relating to the general well-being of the population and improvements in living standards.

A second option is to earmark part of social expenditure, that is, to allocate a certain amount of national budget resources in advance. Many Latin American countries, for example, set minimum levels (usually expressed as percentages of GDP) for expenditures on health or education. The problem is that, despite the best intentions of legislators, such mechanisms do not eliminate the procyclical bias of public spending, since they allow it to fall when GDP declines. What is more, actual spending frequently falls short of these minimum levels because the necessary resources are simply not available and approved budgets are not fully executed. Thus, earmarking public expenditure does not solve the problem because it fails to attack the root of the problem, which is the chronic shortage of public funding during crisis periods.

A third option is to "armour-plate" part of public social expenditure. This approach is an appropriate one, since it has the advantage of recognizing the authorities' capacity to set resource-allocation priorities and to enforce them despite the multiple pressures exerted in the course of the process. A number of recent cases demonstrate that it is possible to define a "hard core" of social expenditure. This certainly contributes to the entire system's governance, even though the persistence of classification problems can still cause difficulties and reduce transparency.

Every situation naturally warrants a different response but, clearly, medium-term strategies must be directed towards developing explicit mechanisms to protect public expenditure so that the enormous needs that arise during recessions can be met.

**Source:** Eduardo Aldunate and R. Martner, "Política fiscal y protección social", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

Latin American countries that have set up pluriannual budget systems tend to set aggregate goals for their planning horizons. In order to do this, they need reliable projections of macroeconomic conditions, income and expenditure, and the impact of policy changes on future budgets. It is essential to continually monitor the validity of these assumptions, since their acceptance by stakeholders and the pluriannual budgets' usefulness for the region's Governments hinges on this accuracy.<sup>21</sup>

In addition to reducing the volatility of social expenditure and its dependency on the business cycle, the level of social expenditure will also have to be raised (unless there is a large enough margin to permit significant reallocations), which will require an increased supply of public resources. This question will be explored in the following section.

## Public revenues: trends and prospects

The need to widen the scope of social protection programmes entails a growing demand for non-contributory benefits and this, in turn, calls for efforts to raise more tax-based financing. To accomplish this, a multidirectional approach will have to be used and tailored to the priorities

<sup>21</sup> Projection errors are not attributable solely to the governments concerned. In fact, an evaluation of fiscal adjustment programmes implemented with support from the International Monetary Fund points up a recurrent trend towards excessive optimism in the economies' growth projections (IMF, 2003).

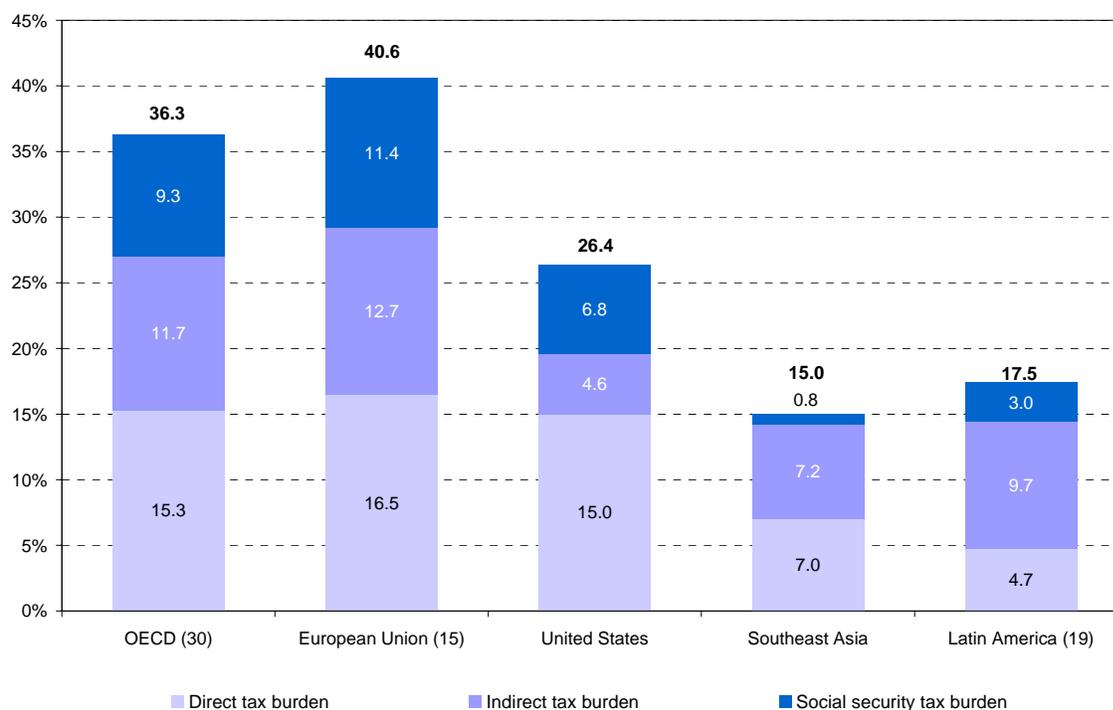
corresponding to the specific circumstances, strengths and weaknesses of each country. To that end, a political agreement must be reached that focuses on the need to establish a new fiscal covenant which reflects a lasting consensus in each society regarding the necessity of providing a foundation for new and more solid social protection systems.

Owing to the diverse levels and composition of fiscal revenues in the region, no one single, standard set of recommendations can be formulated for financing social protection programmes. In general, it is suggested that tax revenues be gradually increased to a level that guarantees fiscal solvency, while at the same time maintaining a tax structure that does not undermine the economy's competitiveness.

### The tax burden, and levels and sources of fiscal revenues

Latin American and Caribbean countries have a tax burden of around 18% of GDP, which is much lower than that of OECD members and close to the average for the South-East Asian countries. Social security contributions are higher than in South-East Asian countries, but lower than in more developed countries (see figure II.11).

Figure II.11  
INTERNATIONAL COMPARISONS OF NATIONAL TAX BURDENS  
(Percentages of GDP)

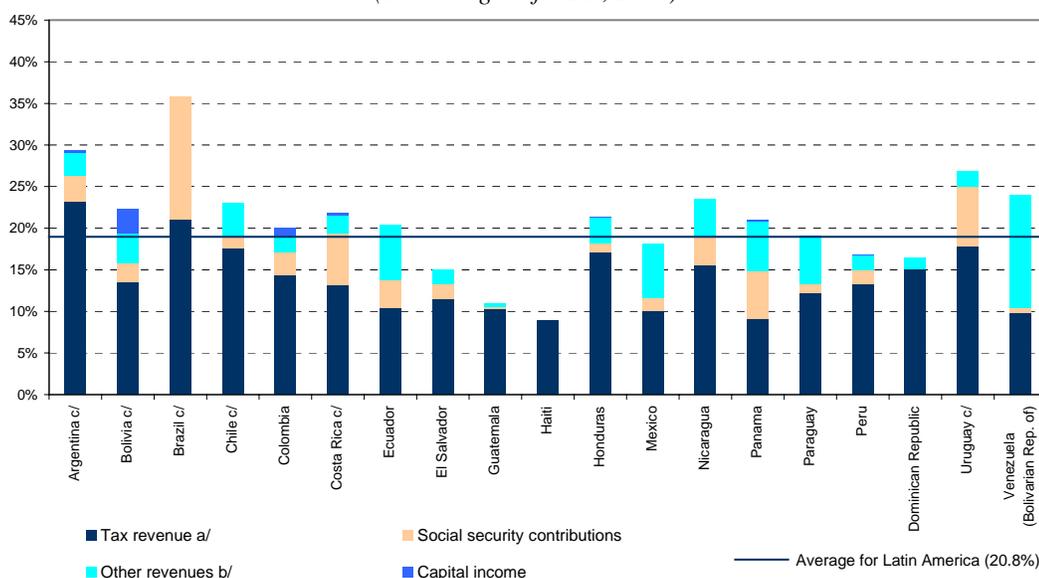


**Source:** OECD countries: Organization for Economic Co-operation and Development (OECD), *Revenue Statistics of OECD Member Countries*, Paris, 2003; South-East Asian countries: International Monetary Fund (IMF), *Government Finance Statistics, 2003*, Washington, D.C., 2003; Latin American countries: Author, based on official figures from each country.

**Note:** OECD figures refer to the general government, as do those of Argentina, Bolivia, Brazil, Chile, Costa Rica, Ecuador, Mexico and Panama. Data for the Latin American countries are for 2003. Data for the OECD countries are for 2002, as are those of the Philippines, Singapore and Thailand. Data for Singapore are for 2002 and those for Indonesia and the Republic of Korea are for 2001.

The countries' varying fiscal positions are reflected in the dispersion fiscal revenues, which range from 35% of GDP in Brazil to around 10% in Guatemala. Sources of fiscal revenues also differ from one country to another, although capital income generally represents a small percentage of total government revenues, except in Colombia. In some countries, tax revenues are virtually the only source of current income for the central government, whereas in others, tax revenues are supplemented with the proceeds from sales of natural resources.<sup>22</sup> In a few countries, foreign grants and donations are also a significant source of revenue (see figure II.12).

Figure II.12  
LATIN AMERICA AND THE CARIBBEAN: THE TAX BURDEN  
(Percentages of GDP, 2004)



Source: Latin American and Caribbean Institute for Economic and Social Planning (ILPES), on the basis of official figures.

<sup>a</sup> Tax revenues are net of refunds.

<sup>b</sup> Donations received are included in "other income". In El Salvador they represent 0.5% of GDP; in Nicaragua, 3.3%, and in the Dominican Republic, 0.2%.

<sup>c</sup> For Argentina, Bolivia, Brazil, Chile and Costa Rica, general government figures have been used. In the remaining countries, the figures shown correspond to the central government.

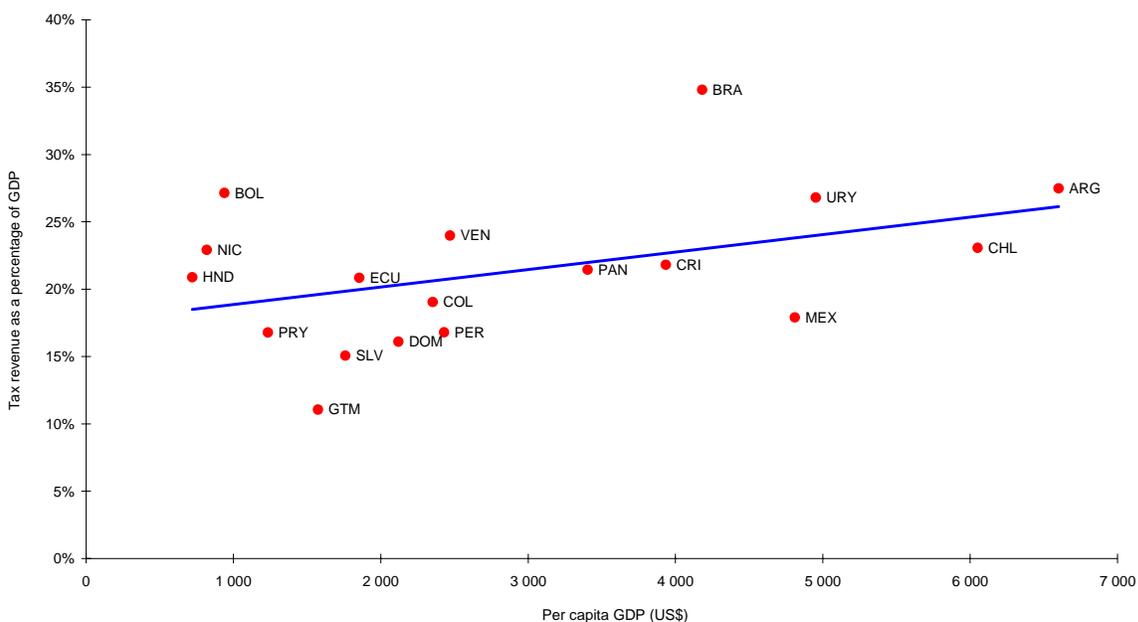
The heterogeneity of the countries' fiscal positions is partially attributable to the broad dispersion of per capita income levels in the region and reproduces the usual pattern whereby the level of fiscal revenues goes hand in hand with advances in economic development (see figure II.13).<sup>23</sup> This also poses problems, since countries with the greatest relative need for social protection (those with the lowest per capita incomes) are also those with the least financial capacity.<sup>24</sup>

<sup>22</sup> In Argentina, Brazil, Colombia, Costa Rica, Guatemala, Haiti, Honduras and Uruguay, tax revenues are virtually the only source of revenue. In the Bolivarian Republic of Venezuela, Bolivia, Chile, Ecuador, Mexico and Peru, tax revenues are supplemented with the proceeds from sales of natural resources. In the cases of Nicaragua, El Salvador and the Dominican Republic, grants and donations are of major importance.

<sup>23</sup> In order to reflect a country's fiscal capacity based on the relationship between income and economic development, panel regressions are usually performed in order to calculate the "optimum" tax burden for each country and then compare it with the actual rate. For a description of the method used, see Tanzi and Zee (2000); for an analysis of recent estimates of fiscal capacity in the MERCOSUR countries, see Barreix, Villela and Roca (2005).

<sup>24</sup> Another aspect of the region's diversity in terms of the various countries' fiscal positions has to do with subnational governments' ability to administer and manage resources. The situation is even more complex when there are intermediary hierarchies that also levy taxes and compete with national and local government hierarchies. This is what occurs in federal countries, although it also happens in a number of unitary countries that are in the process of decentralization. A good example of the relative impact of taxation by subnational governments on the overall tax burden is Brazil, a country where the states and municipalities collect more than 30% of total taxes; in Argentina, Colombia and Uruguay, subnational governments collect around 20% of total tax receipts and, in Peru, Nicaragua and Honduras, they collect around 10% (Cetrángolo, 2006).

Figure II.13  
TAX REVENUES AND PER CAPITA GDP, 2003



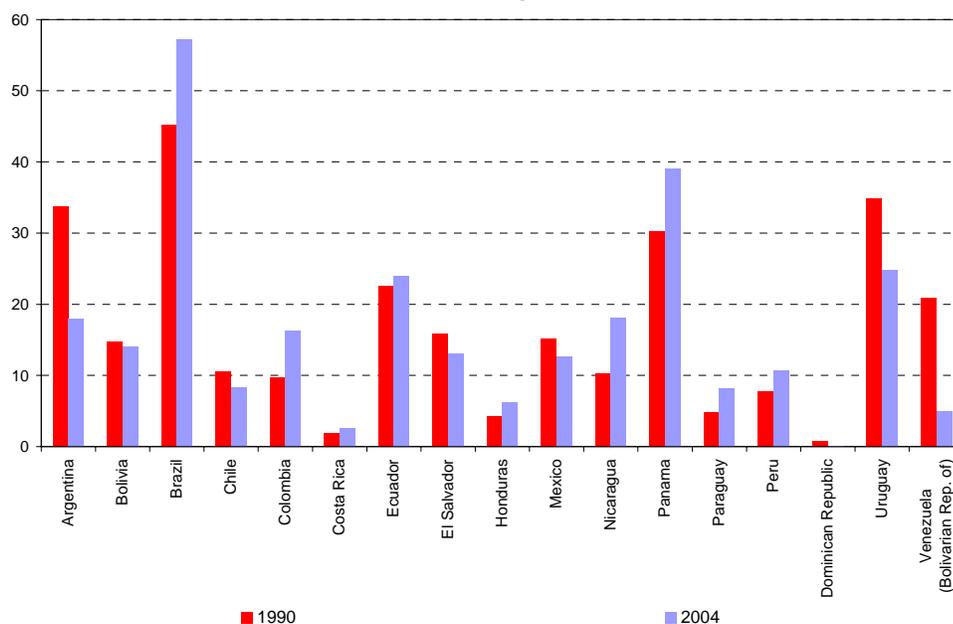
**Source:** Latin American and Caribbean Institute for Economic and Social Planning (ILPES), on the basis of official tax-revenue figures from each country.

**Note:** GDP is expressed at constant 1995 prices. Data for tax revenues include social security contributions and cover the general government in the cases of Argentina, Bolivia, Brazil, Chile, Costa Rica, Ecuador, Mexico and Panama. Data for Mexico and Panama are for 2000.

### Differing shares of total tax revenues provided by social security contributions

Historically, the level of social security contributions has varied widely from one country to another in the region, depending on how developed individual benefit systems are. In recent years, as a consequence of total or partial privatization of pension systems, and in some cases of health systems, social security contributions have declined in relative terms as a source of revenues in nine countries, although in another eight countries their share of the total has increased (see figure II.14). In 2004, social security contributions represented 20% or more of tax revenues in five countries (Brazil, Colombia, Ecuador, Panama and Uruguay) and more than 10% in Argentina, El Salvador and Nicaragua. Two noteworthy cases are Brazil, where more than 55% of central government revenues come from social security contributions (14.4 percentage points of GDP), and Panama, where contributions account for over 30% of the total. The partial privatization of the social security system by some countries in the region has led to a debate as to how fiscal revenues should be posted in such cases. There is no single criterion governing the inclusion of these revenues in fiscal accounts. Box II.8 discusses a number of considerations in this respect.

Figure II.14  
**SOCIAL SECURITY AS A SHARE OF TAX REVENUES, 1990 AND 2004**  
*(Percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

### Box II.8

#### PAYROLL DEDUCTIONS AND THE TAX BURDEN

In reforming benefit systems and their financing, a number of factors should be taken into consideration when assessing whether or not payroll deductions should be viewed as part of the tax burden. Precise guidelines are difficult to establish but, broadly speaking, five different types of arrangements may be distinguished, based on the type of contribution (i.e., whether it is compulsory or elective), the nature of the institutions in charge of such benefits and the redistributive effect, if any, of benefit financing:

1. Where contributions are compulsory, the system is run by public institutions and benefits fulfil a redistributive function, then, clearly, contributions should be regarded as part of the tax burden, and the corresponding expenditure must be viewed as public spending. Examples include the pension systems of Brazil, Costa Rica, Panama and Paraguay; the health system in Costa Rica; Chile's National Health Fund and Argentina's social Solidarity And Redistribution Fund.
2. Where contributions are compulsory and the system is managed by public institutions, but benefits do not fulfil a redistributive purpose and are instead organized by the "benefit principle", then expenditure is public but the resources should not be viewed as taxation-derived. An example of this special sort of situation would be a pure system of notional accounts with no redistributive component.
3. Where contributions are compulsory and they finance benefits that are apportioned on a redistributive basis but the system is run by private institutions, they should not be considered part of public expenditure, nor should the resources be counted as forming part of the tax burden. Nonetheless, since they finance social expenditure, such contributions should be taken into account in social policy analysis. Colombia's and Uruguay's health systems are organized in this way.
4. Where contributions are compulsory and are collected by private institutions that run benefit systems having no redistributive function, such benefits should not be deemed public expenditure and their funding should not be viewed as part of the tax burden, since it is used for the acquisition of merit goods that are comparable to safety belts or vehicle insurance. Examples of such schemes include the pension fund management companies of the Chilean and Argentine pension systems and the private health insurance providers (ISAPREs) in Chile's health system.
5. Lastly, elective contributions obviously do not form part of the tax burden.

Clearly, every country has its own system for organizing its public accounts with its own particular requirements, and presents the information accordingly.

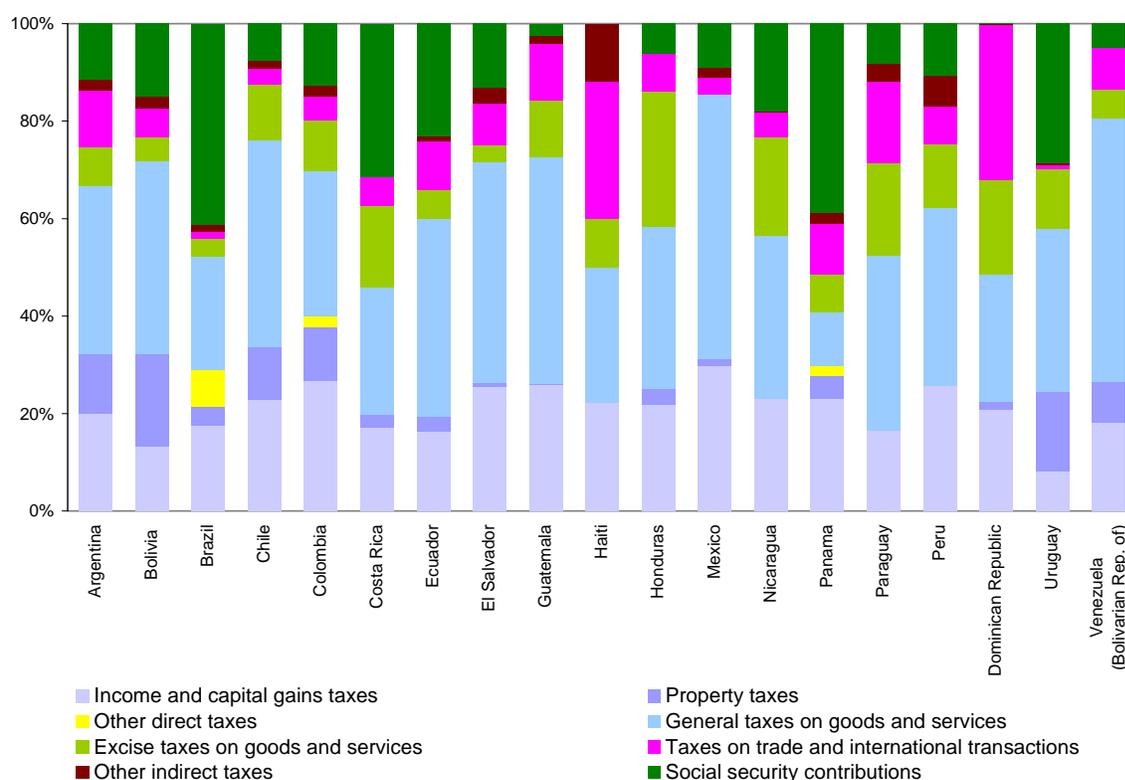
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

## Policy guidelines for increasing the tax burden

In addition to the heterogeneity of national tax structures in the region, in most cases there are a series of characteristics that are useful in analysing tax issues and defining ways to strengthen the tax structure. As figure II.15 shows, Latin American and Caribbean tax systems are based mainly on indirect taxes, and direct tax receipts are lower than they are in other regions of the world.<sup>25</sup> In addition, in recent years the region has witnessed a downturn in the share of revenue provided by taxes on external trade, an increase in the relative level of VAT receipts, a lack of substantive progress with regard to income taxes, a concentration of the system via a reduction in the number of different types of taxes and the development of extraordinary or emergency tax schemes (Gómez Sabaini, 2005).

Based on these common characteristics, a number of recommendations can be made (see box II.9) whose application may be practicable, albeit to differing extents, for many of the countries in the region. These recommendations concern measures for gradually broadening the “menu” of sources of tax revenues, strengthening the tax base and improving the tax system’s redistributive effects.

Figure II.15  
**LATIN AMERICA: COMPOSITION OF TAX REVENUES, 2004**  
*(Percentages of total)*



**Source:** Latin American and Caribbean Institute for Economic and Social Planning (ILPES), on the basis of official data.

**Note:** Figures are for the central government in all countries except Argentina, Bolivia, Brazil and Chile, where the data correspond to the general government. Data for Bolivia, Brazil and Chile are for 2003.

<sup>25</sup> The situation differs in English-speaking Caribbean countries, where direct taxes form a larger proportion of tax revenues. On this subject, see ECLAC (1998).

## Box II.9

**GUIDELINES FOR INCREASING TAX REVENUES IN THE REGION**

Best practices in taxation in Latin America and the Caribbean provide the basis for a number of recommendations in this regard:

1. Tax bases should be strengthened in general.
2. The VAT base should be expanded wherever possible, with exemptions being retained only in cases where this is justified on the grounds of tax administration or equity. It is preferable to use VAT exemptions than to have a zero tax rate on domestic activities because the latter hampers tax administration. The VAT should not be used as an economic policy tool.
3. The tax system's redistributive impact should be enhanced by combining the VAT with selective taxes rather than by introducing a wide variety of rates.
4. Since many countries will find it difficult to continue using the VAT as their main source of additional revenues, they will need to have recourse to other sources of taxation.
5. The income tax structure should be modified in order to give greater weight to personal income tax relative to corporate taxes.
6. Since it is difficult to raise tax rates above a certain threshold, it should be borne in mind that the personal tax structure relies too heavily on wage income. Currently exempt forms of personal income (such as financial rents, capital gains and so forth) should therefore be taxed.
7. Until the relevant measures are taken, which is unlikely to occur in the very near future, corporate taxes should be maintained in order to avoid a decrease in revenues. Admittedly, however, financial and trade liberalization measures have left this tax open to many tactics for its avoidance (in the form of transfer prices, interest deductions and so on), and these flaws need to be corrected as soon as possible.
8. The introduction of various types of presumptive taxation is justifiable as a temporary or emergency measure. Emergency modes of taxation will have to be kept in place—while taking care to avoid unwanted impacts on equity and economic competitiveness—until the tax administration structure is developed enough to play a part in shaping new, more mature systems that can ensure fiscal solvency. Such systems can also be useful in bringing segments of the informal sector, which has traditionally avoided paying taxes, into the mainstream economy.
9. Governments should raise taxes on assets, while duly recognizing subnational levels' spheres of authority.

These recommendations were formulated by a regional expert group as part of a workshop on taxation in Latin America held in 2005 under the auspices of the Secretariat of ECLAC.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

Increasing the tax burden over the medium term will necessarily entail strengthening the system of tax administration. It will also require an institutional framework and provisions that are aligned with that system's functions and objectives. In recent years, an awareness of these requirements has led to the adoption of administrative reforms to raise the rank of tax administration institutions in the hierarchy. Major progress in the area of institution-building has also been made by creating legal structures that endow these administrative institutions with varying levels of operational, managerial, technical and financial autonomy. This has been the case in Argentina, the Bolivarian Republic of Venezuela, Colombia, Cuba, Ecuador, Honduras, Mexico, Panama and Peru, among others.<sup>26</sup> In order for a tax administration system to be effective, it must have a stable budget, be able to perform its duties without being influenced by external pressures and have an institutional framework that makes reforms sustainable while protecting them from policy swings. In addition, the judicial system's capacity to support the tax administration system must be increased. In many cases, the adoption of measures for improving tax administration generates a demand for additional budget resources, since this calls for the consolidation of stable, predictable tax systems in order to guard against successive changes in the rules of the game. A stable and predictable system facilitates the tax authority's performance of its administrative and oversight tasks and tends to lead to an increase in taxpayers' voluntary compliance, reduce the cost of compliance for taxpayers and lessen the likelihood of corruption.<sup>27</sup> In addition, changes in the

<sup>26</sup> Tax administration institutions are headed by public officials with the rank of deputy minister in Costa Rica and Cuba, under-secretary in Mexico, secretary in Argentina and Brazil, and superintendent in the Bolivarian Republic of Venezuela and Peru.

<sup>27</sup> Many countries have achieved positive results by segmenting taxpayers, defining differentiated administrative strategies and simplifying procedures wherever possible. The use of new computerized management systems is a challenge for virtually all the

world economy, in particular growing globalization and economic integration, call for the establishment of modern administrative systems which are in line with these changes and are capable of assisting in the effort to combat the increasingly complex problem of tax evasion.

## Summary

The region's heterogeneity is reflected in a wide variety of challenges in relation to the expansion of non-contributory coverage. Each country has differing needs and possibilities when it comes to redeploying social expenditure or, where this is not possible, increasing the tax burden. It is, generally speaking, feasible to increase tax collection, especially when the macroeconomic environment is favourable. In some countries, rates are comparatively low, especially in the case of VAT and excise taxes, and there are also a number of exemptions that could be reconsidered. In cases where it is becoming increasingly difficult to introduce new taxes or raise tax rates, the elimination of exemptions and the limitation of tax deductions could serve as important sources of tax revenues in the future. Improvements in tax administration can also play an important role.

Far from recommending simple and general solutions, the aim would be to initiate a series of reforms on a sustained basis with a view to creating a stronger, more mature system of government financing. Such reforms will be essential components of the effort to consolidate public policies that guarantee economic and social rights to the inhabitants of the region. Clearly, a lasting consensus will have to be built in order to ensure the success of these initiatives.

As the region strives to reach the necessary agreements for the adoption of a fiscal covenant to reinforce social protection financing, factors that will have to be taken into consideration include the following: (i) the political and institutional difficulties involved in introducing reforms to strengthen the public sector's solvency and to distribute the tax burden more equitably; (ii) the constraints imposed by macroeconomic conditions, inasmuch as the experience of the past two decades has shown that macroeconomic stability, understood as rapid and stable growth in conjunction with low inflation, is the main prerequisite for an increase in tax revenues; and (iii) fiscal policy priorities as they relate to expenditure vis-à-vis the wide range of demands for resources for purposes that are not necessarily linked to social protection.

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countries in the region. In addition, the capacity of some countries' regional and local tax authorities has been increased significantly, depending on their institutional organization.



## Chapter III

# Social protection and health systems

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## Introduction

Access to health services is a key component of economic and social rights. To the extent that society can guarantee all its members adequate care with regard to the vicissitudes of health, it can advance towards the actual materialization of those rights and enforceable entitlement to them. Achieving this gives citizens a stronger sense of protection and belonging to the community.

Health policies in Latin American and Caribbean countries are facing both emerging and older challenges. As in the developed world, changes in the pattern of demand driven by demographic, epidemiological and technological trends are raising new challenges. These shifts are making new forms of health care and treatment both possible and necessary, thereby increasing health service costs and the associated expenditures. The older challenges stem from the region's long-standing shortcomings in terms of equitable real access to timely and quality health services, lack of human and financial resources, and problems of articulation between the different systems. The imperative of moving towards universal provision of health services clearly places additional pressure on demand and expenditure in the sector.

Health-care reform in the region has to pursue a twofold objective. First, it must strengthen solidarity mechanisms designed to provide equitable access to health services to the whole population, regardless of individual income or risk. Second, it must contain costs and allocate the scarce resources available more efficiently, to optimize the response to the technological, demographic and epidemiological changes that are unfolding in the region.

Policies that contribute to achieving these objectives include interventions in many aspects of public policy, including those pertaining to the health sector (e.g., regulation of the pharmaceutical industry and education on prevention and hygiene), along with public infrastructure, drinking water and sanitation works, housing initiatives and others. Notwithstanding the undoubted importance of these factors, the need to delineate the scope of the analysis has led to a particular focus in this chapter on reforms to the organization of health-service financing and delivery.

From the point of view of financing, the proposal advanced in this chapter is to move towards the integration of public systems and social security, in order to reduce the inequities that tend to occur in segmented schemes and delink access to adequate services from the individual's medical risk and ability to pay. In terms of health-service organization, it is suggested that the financing and service-delivery functions should be separated, based on service-contracting mechanisms that provide incentives to use resources in a rational manner. The chapter will discuss the advantages of establishing a set of priority health-care services, which would increase as a function of each country's financing capacity, in the framework of explicit, guaranteed and universal coverage. Consideration is also given to policies for expanding primary care and adequately coordinating decentralized services, with a view to improving coverage and access to health care.

There follows an examination of a number of stylized facts regarding health in Latin America and the Caribbean. These refer to the region's health needs and epidemiological profile, and the coverage, organization and level of health spending. The challenges faced by reform processes in the light of the heterogeneous situations in the different countries are also analysed. Lastly, a number of recommendations are advanced, including integration of insurance systems; separation and efficient contracting of service provision; establishment of explicit universal and guaranteed coverage packages; expansion of primary care networks; and coordination of decentralized systems.

## Stylized facts

The range of health-system reforms in the region is shaped by the organization and level of coverage provided by the different systems, their capacity and mode of financing, and demographic and epidemiological patterns in the population in question. Although for the purposes of this chapter the discussion focuses on the organization of financing for health service provision, it should not be forgotten that health depends on a wide range of factors relating to the economic and social conditions in which people live. As argued in the review of progress towards achievement of the Millennium Development Goals in the region (United Nations, 2005), a global health policy must take account of interactions between the different areas of public policy (see box III.1).

## Box III.1

**INTERSECTORAL INTERVENTIONS ACTING ON THE SOCIAL DETERMINANTS OF HEALTH**

Health is a multidimensional issue that requires intersectoral interventions integrated into wider development and poverty-reduction strategies. Accordingly, improving health services requires broad action on social policies in general, moving beyond the concept of watertight compartments, and recognizing the levels of interdependence that exist among the different goals. It is necessary to exploit synergies between public policies and interdisciplinary, intersectoral measures that target the most vulnerable groups and most disadvantaged areas and countries.

The available data show that child and maternal mortality rates can be reduced through collaborative efforts in the domains of health and education. The various aspects of sexual and reproductive health also call for concerted responses that engage the different sectors (e.g. those associated with employment and with the justice system, among others), along with measures aimed at empowering individuals and communities, especially adolescents and women.

The high correlation found between child mortality rates and the proportion of the population with access to safe drinking water is further evidence of the need for intersectoral programmes aimed at changing the environment in which people go about their lives. Such programmes should target the most vulnerable and employ the family, school, community, organized civil society and municipalities as articulating units. Intersectoral organizational structures also need to be established.

The “healthy municipalities” strategy is an example of a multidimensional approach to public health issues, which aims to improve health conditions among the most vulnerable population groups and to enhance the sustainability of programmes implemented at the municipal level. The strategy reflects a local development approach that involves the community in decision-making and programme implementation.

**Source:** United Nations, *The Millennium Development Goals: A Latin American and Caribbean Perspective* (LC/G.2331-P), J.L. Machinea, A. Bárcena and A. León (coords.), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005. United Nations publication, Sales No. E.05.II.G.107.

### Health-care needs, epidemiological profile and benefits that can be universalized

As indicated in chapters I and II, the limited funding available for social protection forces every society to set priorities regarding the range and quality of the benefits it wishes to provide to the population at large. In the case of health protection, this translates into defining packages of universal coverage, as this chapter will argue. The population’s basic health-care needs, i.e., the set of pathologies that represent the highest risk of mortality and morbidity, should be the first to be included such a package.<sup>1</sup>

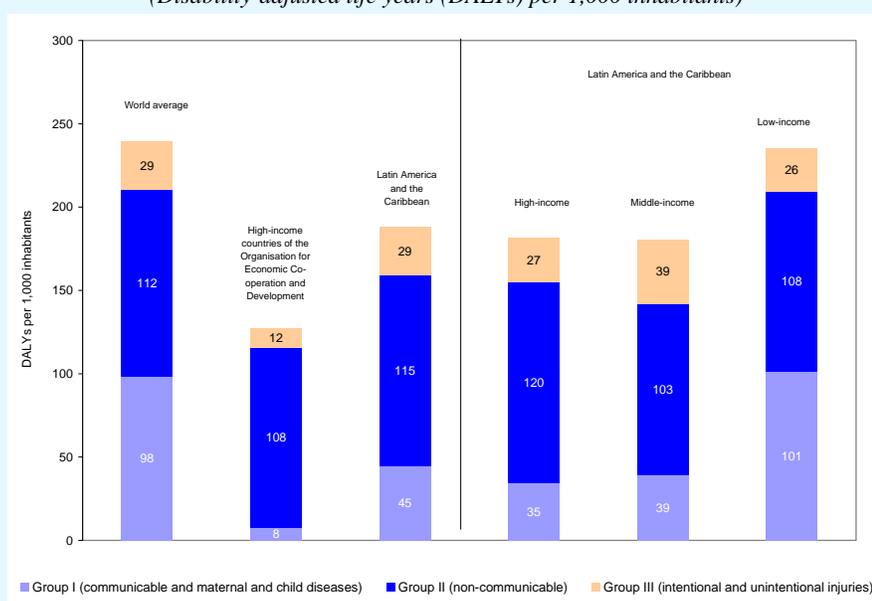
The situation as regards health-care needs in Latin America and the Caribbean is highly variable, and, in some cases, disturbing. While, at the aggregate level, the region is rapidly closing in on the developed countries in terms of non-communicable diseases, it has yet to come fully to grips with the ailments associated with underdevelopment, such as communicable and maternal and child diseases (see box III.2). This phenomenon, which is referred to as “epidemiological backlog,” creates a twofold problem for health-care systems in Latin America and the Caribbean. There is also an uneven subregional pattern whereby the epidemiological backlog is much more severe in lower-income countries and, moreover, weighs most heavily on their child populations.

<sup>1</sup> The alternative is to base the package on patterns of consumption and supply of health care services, as is implicitly done in many countries. Internationally, however, it has been found that such approaches usually fail to accurately reflect real health needs. Instead, providers are able to structure their supply in such a way as to encourage demand for their services; and higher-income families tend to seek more, and more complex, health services.

Box III.2  
**BURDEN OF DISEASE AND EPIDEMIOLOGICAL BACKLOG  
 IN LATIN AMERICA AND THE CARIBBEAN**

The figure below displays an estimate of disability-adjusted life years (DALYs), by region and cause. A DALY may be thought of as one lost year of healthy life, and is thus a “burden of disease” indicator often used in summarizing a population’s health needs. It provides a basis for ranking the main health problems in different countries, by showing the relative significance of different diseases in terms of premature deaths and years of life lost through disability. The total number of DALYs per 1,000 inhabitants is divided into three broad groups of causes, as defined by the World Health Organization (WHO). Group I encompasses communicable illnesses (infectious and parasitic diseases) and maternal and perinatal conditions and nutritional deficiencies; group II comprises non-communicable conditions (which include, in particular, cancer and cardiovascular, respiratory and neuropsychiatric conditions); and, lastly, group III covers intentional and unintentional injuries (accidents and violence).

**LATIN AMERICA AND THE CARIBBEAN AND THE REST OF THE WORLD:  
 BURDEN OF DISEASE INDICATORS, 2002**  
*(Disability-adjusted life years (DALYs) per 1,000 inhabitants)*



**Source:** Figures provided by the Global Burden of Disease Project, World Health Organization (WHO), Geneva. The countries of the region were divided into three groups by per capita GDP.

Although the overall level of DALYs in the region is substantially below the world average, it is almost 50% above the figure for high-income countries of the Organisation for Economic Co-Operation and Development (OECD). Disaggregating these data by cause and country groupings sheds additional light on the diversity and complexity of the health situation in the region. In aggregate terms, the lower-income countries shoulder a higher burden of disease that is very close to the world average. Regional diversity is revealed more dramatically in the breakdown of DALYs by cause. The middle- and high-income countries display a lower incidence of communicable diseases —considered to capture most of the illnesses associated with lower levels of development— than low-income countries do. The following table shows the differential effect of the burden of disease as a function of the population’s demographic and gender composition. As might be expected, the burden of non-communicable diseases is concentrated in the oldest age group (both men and women), whereas communicable diseases and other group I causes account for the largest proportion of morbidity and mortality in the 0-14 age group. Lastly, another of the region’s traits is a high rate of mortality caused by accidents and violence, especially among adult males.

Box III.2 (concluded)

**LATIN AMERICA AND THE CARIBBEAN: BURDEN OF DISEASE INDICATORS BY  
AGE GROUP, GENDER, CAUSE AND INCOME BRACKET, 2002**  
(Disability-adjusted life years (DALYs) per 1,000 inhabitants)

|              | High income      |                  |          |            | Middle income    |                  |          |            | Low income       |                  |            | All causes |          |
|--------------|------------------|------------------|----------|------------|------------------|------------------|----------|------------|------------------|------------------|------------|------------|----------|
|              | Groups of causes |                  |          | All causes | Groups of causes |                  |          | All causes | Groups of causes |                  | All causes |            |          |
|              | Communicable     | Non-communicable | Injuries |            | Communicable     | Non-communicable | Injuries |            | Communicable     | Non-communicable |            |            | Injuries |
| <b>Total</b> | 34.8             | 120.0            | 26.6     | 181.4      | 39.3             | 102.8            | 38.5     | 180.5      | 101.3            | 108.0            | 25.8       | 235.1      |          |
| <b>0-14</b>  | 79.6             | 66.0             | 20.6     | 166.2      | 69.4             | 57.9             | 24.3     | 151.6      | 170.7            | 65.9             | 22.4       | 259.1      |          |
| <b>Men</b>   | <b>15-59</b>     | 15.9             | 127.0    | 59.3       | 202.2            | 28.1             | 105.4    | 90.5       | 224.0            | 54.3             | 115.4      | 55.2       | 225.0    |
|              | <b>60+</b>       | 21.9             | 323.9    | 14.3       | 360.1            | 25.1             | 275.9    | 18.7       | 319.7            | 46.0             | 312.2      | 19.5       | 377.7    |
|              | <b>Total</b>     | 35.8             | 123.7    | 44.0       | 203.5            | 41.2             | 102.5    | 64.0       | 207.7            | 99.2             | 107.5      | 40.4       | 247.1    |
| <b>Women</b> | <b>0-14</b>      | 67.8             | 66.3     | 10.8       | 144.9            | 59.8             | 59.3     | 13.3       | 132.4            | 161.6            | 67.6       | 11.8       | 241.0    |
|              | <b>15-59</b>     | 20.5             | 113.7    | 10.1       | 144.3            | 28.5             | 103.3    | 13.7       | 145.5            | 71.9             | 113.2      | 11.4       | 196.5    |
|              | <b>60+</b>       | 18.3             | 282.8    | 5.1        | 306.2            | 19.0             | 262.1    | 6.9        | 288.0            | 42.5             | 295.4      | 6.0        | 343.9    |
|              | <b>Total</b>     | 33.7             | 116.3    | 9.8        | 159.9            | 37.4             | 103.0    | 13.0       | 153.4            | 103.5            | 108.5      | 11.2       | 223.1    |

Source: Figures provided by the Global Burden of Disease Project, World Health Organization (WHO), Geneva.

This complex epidemiological panorama offers little room for “quick-fix” improvements in the region’s health status. While in some countries it is certainly essential to invest more in public health and in service effectiveness in order to reduce the high rates of communicable and maternal and childhood diseases, the prevalence of non-communicable illnesses, too, has now increased so much that low-cost solutions, such as “reducing malarial mosquitoes by providing people in endemic areas with insecticide-treated bednets” in Africa, are rendered insufficient (Sachs, 2005; United Nations Millennium Project, 2005).

Moreover, the projected ageing of the population means that the burden of non-communicable diseases is bound to rise over time, so the demand for more costly health-care services is sure to increase. The need to address the epidemiological backlog and demographic transitions, while also expanding coverage, unequivocally points to the need for additional funding for the region’s health systems. Thus, all health policies must find a way to make the expansion of coverage and equitable access, on the one hand, compatible with cost containment and more efficient resource allocation, on the other.

### Coverage of health care

The concept of coverage is less precise in the health sector than in other domains of social policy. First, a distinction must be drawn between legal coverage and actual coverage. The former reflects a legal provision and describes citizens’ rights as regards health care, whereas the latter refers to availability, the time and mode of access and the use given to appropriate health services.<sup>2</sup> Virtually all of the region’s constitutions, health legislations and social security systems establish the right to health care, usually on a universal basis, provided through the public sector. In many cases, however, this legal coverage is not accompanied by mechanisms that could make it fully available. In practice, effective access to the required services is often rationed through waiting lists or segmented through multiple insurance schemes.

Indicators on the outcomes of public health policies on maternal and child health provide a first approach to evaluating effective coverage of health systems. Table III.1 shows two indicators—the rate of child immunization against measles and the percentage of births attended by skilled health personnel—for different groups of countries and regions. Overall, the figures for Latin American and the Caribbean are above the developing country average,

<sup>2</sup> See Madies, Chiarveti and Chorny (2002) for an analysis of “real” (actual) and “theoretical” (legal) coverage in the region.

with immunization rates of over 90%, and 82% of births attended by skilled personnel, which attests to major health-policy efforts deployed in the region, particularly in the area of maternal and child health.

Table III.1  
**LATIN AMERICA AND THE CARIBBEAN: INDICATORS OF PRIMARY CARE AND PUBLIC HEALTH OUTCOMES**

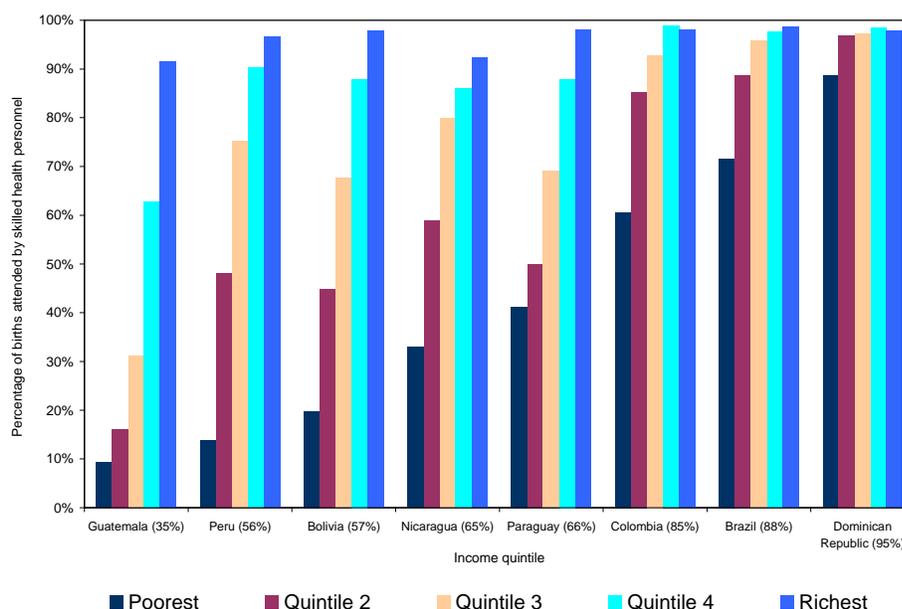
| Country   | Children under one year<br>of age immunized<br>against tuberculosis<br>(percentages) | Children under one year<br>of age immunized<br>against measles<br>(percentages) | Births attended<br>by skilled health<br>personnel<br>(percentages) |
|---|--|---|--|
|   | 2003   | 2003  | 1995-2003  |
| Antigua and Barbuda   | ..   | 99  | 100  |
| Argentina   | 99   | 97  | 99   |
| Bahamas   | ..   | 90  | 99   |
| Barbados  | ..   | 90  | 91   |
| Belize  | 99   | 96  | 83   |
| Bolivia   | 94   | 64  | 65   |
| Brazil  | 99   | 99  | 96.7*  |
| Chile   | 94   | 99  | 100  |
| Colombia  | 96   | 92  | 86   |
| Costa Rica  | 87   | 89  | 98   |
| Cuba  | 99   | 99  | 100  |
| Dominica  | 99   | 99  | 100  |
| Ecuador   | 99   | 99  | 69   |
| El Salvador   | 90   | 99  | 69   |
| Grenada   | ..   | 99  | 99   |
| Guatemala   | 97   | 75  | 41   |
| Guyana  | 95   | 89  | 86   |
| Haiti   | 71   | 53  | 24   |
| Honduras  | 91   | 95  | 56   |
| Jamaica   | 88   | 78  | 95   |
| Mexico  | 99   | 96  | 86   |
| Nicaragua   | 94   | 93  | 67   |
| Panama  | 87   | 83  | 90   |
| Paraguay  | 70   | 91  | 71   |
| Peru  | 94   | 95  | 59   |
| Dominican Republic  | 90   | 79  | 99   |
| Saint Kitts and Nevis   | 99   | 98  | 99   |
| Saint Lucia   | 95   | 90  | 100  |
| Saint Vincent and the Grenadines  | 87   | 94  | 100  |
| Suriname  | ..   | 71  | 85   |
| Trinidad and Tobago   | ..   | 88  | 96   |
| Uruguay   | 99   | 95  | 100  |
| Venezuela (Bolivarian Republic of)  | 91   | 82  | 94   |
| Developing countries  | 85   | 75  | 59   |
| Least developed countries   | 79   | 67  | 34   |
| Latin America and the Caribbean   | 96   | 93  | 82   |
| Organisation for Economic<br>Co-Operation and Development,<br>high-income countries | ...  | 92  | 99   |
| World average   | 85   | 77  | 62   |

**Source:** United Nations Development Programme (UNDP), *Human Development Report 2005*, New York, 2005, except (\*) where the figure was obtained from the Ministry of Health of Brazil ([www.datasus.gov.br](http://www.datasus.gov.br)).

Nonetheless, the relatively good regional average masks a very uneven pattern of health status across the region. The poorer countries report much lower values for these indicators—even below world averages, and in some cases close to the levels displayed by the world's least developed countries.

National averages also conceal major access inequities suffered by the most vulnerable sectors within each country. Figure III.1 shows the percentage of births attended by skilled health personnel for each income quintile in nine of the region's countries. In practically all the countries, and for nearly all indicators, there is a direct and increasing link between families' socio-economic status and access to skilled personnel at delivery.

Figure III.1  
**BIRTHS ATTENDED BY SKILLED HEALTH PERSONNEL, AROUND 2002**



Source: World Bank, *Socio-Economic Differences in Health, Nutrition, and Population*, Washington, D.C., 2004.

The major inequities identified using this basic indicator of health care coverage, both in the international comparisons and by income level, are partly attributable to economic and social factors and to differences in geographical accessibility of primary health-care facilities (PAHO, 2004), but they are also strongly conditioned by the segmentation of the health systems in many of the region's countries.<sup>3</sup>

Undoubtedly, despite the relatively encouraging results achieved by public health policies, the region's countries face a major challenge to improve equity and reduce exclusion from their health systems. The endemic scarcity of resources plays a role in these problems, but they are also wrought by shortcomings in the way the sector is organized.

<sup>3</sup> The patterns presented here coincide with data published by the World Bank (2004) on other primary health care indicators, and with other studies carried out in the region (IDB, 2005). Using an indirect method for the period 1990-1994, Paganini (1998) concluded that roughly 8% of the region's total population had not been immunized against polio and tuberculosis, and 29% lacked adequate prenatal care. A report by the Pan-American Health Organization entitled *Health in the Americas* (PAHO, 2002), which examines the level of exclusion from health care in Latin America and the Caribbean, found that 46% of the region lacked health insurance, 27% were excluded for economic reasons, and 22% for geographic reasons.

## Organization of health systems

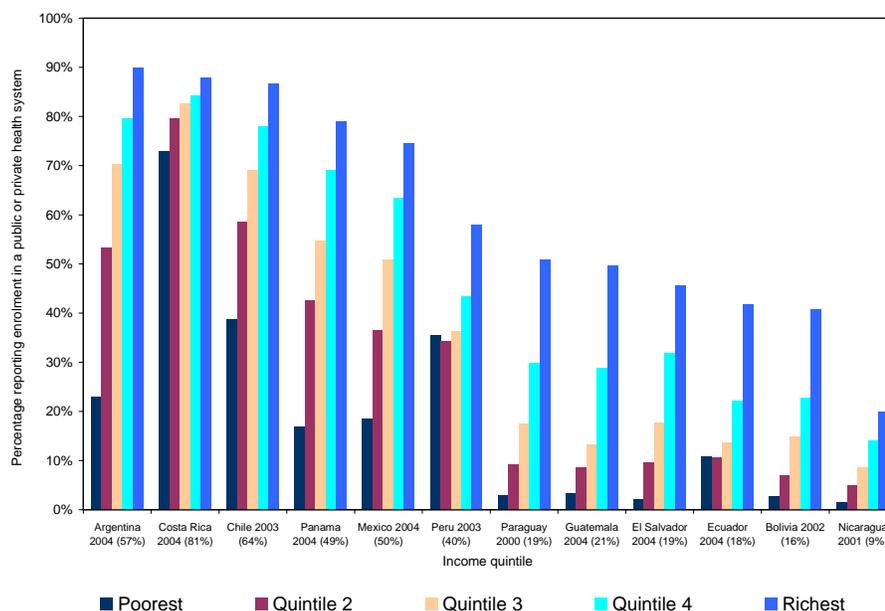
The Latin American and Caribbean countries' health sectors are characterized by a diverse range of institutions and mechanisms for financing, insurance, regulation and service delivery. These functions are usually articulated through a public health system, a social security system and the private sector. The way these three subsectors are coordinated and articulated gives rise to different modalities of operation in the health sector.<sup>4</sup>

The English-speaking Caribbean countries generally have unified systems financed essentially on a non-contributory basis through taxes and budgetary allocations; there is no explicit separation between the procurement, insurance and service delivery functions, and the private sector plays a role that is secondary and complementary to the public system.

In most Latin American countries, in contrast, the public, private and social-security subsystems all coexist, which results in greater disaggregation in terms of both financing sources and delivery structure. It also circumscribes solidarity mechanisms and the capacity to rationalize and coordinate delivery supply. As figure III.2 shows, affiliation to social security and private insurance plans is very much a function of income distribution. Households in the higher quintiles report a higher level of affiliation to insurance plans, whereas families in the first and second quintiles tend to be enrolled in the public system. Even within either the social-security or private system, however, coverage is not uniform, since the quality and type of service is usually linked to affiliates' contribution levels or co-payment capacity. As discussed below, the way in which countries have gone about restructuring relations among these three sectors forms a basis for classifying the reforms undertaken in the region.

Figure III.2

### PERCENTAGE OF HOUSEHOLDS REPORTING AFFILIATION TO SOCIAL SECURITY OR PRIVATE HEALTH INSURANCE SCHEMES



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys for the relevant countries.

<sup>4</sup> In general, the public sector is usually the only source of coverage available to people unable to pay: those who are uninsured use the network of public providers. Social security covers formal workers (and their dependants) and has its own network of hospitals and service providers. The private sector generally covers the highest-income groups through a structure of private providers. Nonetheless, this sector also relies heavily on various non-profit organizations, particularly in lower-income countries, which serve low-income population groups.

## Health service expenditure and financing

Health expenditure as a proportion of gross domestic product (GDP) is a first indicator that serves to compare health expenditure across countries. On this basis, the economies of Latin America and the Caribbean compare favourably with the world average and come close to those of high-income OECD countries (see table III.2).<sup>5</sup>

Table III.2  
LATIN AMERICA AND THE CARIBBEAN: DISTRIBUTION AND  
LEVEL OF EXPENDITURE ON HEALTH, 2002

| Country                                 | Total expenditure (percentages of GDP) | Per capita total expenditure (purchasing power parity dollars) | Per capita public expenditure and social security (purchasing power parity dollars) | Distribution of total expenditure on health (percentages) |                 |                           |               |                                    |
|---|--|--|---|---|-----------------|---------------------------|---------------|------------------------------------|
|   |  |  |   | Public expenditure  | Social security | Private expenditure       |               |                                    |
|   |  |  |   |   |                 | Total private expenditure | Out-of-pocket | Private insurance and health plans |
| Antigua and Barbuda                     | 4.8                                    | 527  | 361   |   | 68.6            | 31.4                      | 31.4          | -                                  |
| Argentina                               | 8.9                                    | 956  | 480   | 21.7  | 28.5            | 49.8                      | 31.1          | 15.5                               |
| Bahamas                                 | 6.9                                    | 1 074  | 522   | 47.6  | 1.0             | 51.4                      | 20.7          | 30.1                               |
| Barbados                                | 6.9                                    | 1 018  | 696   |   | 68.4            | 31.6                      | 24.4          | 7.2                                |
| Belize                                  | 5.2                                    | 300  | 142   | 37.1  | 10.2            | 52.7                      | 52.7          | -                                  |
| Bolivia                                 | 7.0                                    | 179  | 107   | 20.9  | 38.9            | 40.2                      | 32.7          | 3.8                                |
| Brazil                                  | 7.9                                    | 611  | 280   |   | 45.9            | 54.1                      | 34.7          | 19.4                               |
| Chile                                   | 5.8                                    | 642  | 290   | 28.4  | 16.7            | 54.9                      | 26.7          | 28.2                               |
| Colombia                                | 8.1                                    | 536  | 444   | 33.7  | 49.2            | 17.1                      | 9.7           | 5.4                                |
| Costa Rica                              | 9.3                                    | 743  | 486   | 11.2  | 54.2            | 34.6                      | 34.3          | 0.3                                |
| Cuba                                    | 7.5                                    | 236  | 204   |   | 86.5            | 13.5                      | 10.2          | -                                  |
| Dominica                                | 6.4                                    | 310  | 221   |   | 71.3            | 28.7                      | 28.7          | -                                  |
| Ecuador                                 | 4.8                                    | 197  | 71  | 23.3  | 12.7            | 64.0                      | 56.6          | 1.5                                |
| El Salvador                             | 8.0                                    | 372  | 166   | 24.8  | 19.9            | 55.3                      | 51.9          | 3.4                                |
| Grenada                                 | 5.7                                    | 465  | 330   |   | 71.0            | 29.0                      | 29.0          | -                                  |
| Guatemala                               | 4.8                                    | 199  | 94  | 20.7  | 26.8            | 52.5                      | 45.3          | 2.7                                |
| Guyana                                  | 5.6                                    | 227  | 173   |   | 76.3            | 23.7                      | 23.7          | -                                  |
| Haiti                                   | 7.6                                    | 83   | 33  |   | 39.4            | 60.6                      | 42.1          | -                                  |
| Honduras                                | 6.2                                    | 156  | 80  | 42.3  | 8.9             | 48.8                      | 41.7          | 3.6                                |
| Jamaica                                 | 6.0                                    | 234  | 134   |   | 57.4            | 42.6                      | 26.3          | 13.8                               |
| Mexico                                  | 6.1                                    | 550  | 247   | 15.3  | 29.6            | 55.1                      | 52.1          | 3.0                                |
| Nicaragua                               | 7.9                                    | 206  | 101   | 35.3  | 13.8            | 50.9                      | 48.9          | 2.0                                |
| Panama                                  | 8.9                                    | 576  | 413   | 38.9  | 32.8            | 28.3                      | 23.1          | 5.2                                |
| Paraguay                                | 8.4                                    | 343  | 131   | 26.6  | 11.5            | 61.9                      | 54.8          | 7.1                                |
| Peru                                    | 4.4                                    | 226  | 113   | 28.5  | 21.4            | 50.1                      | 39.8          | 8.6                                |
| Dominican Republic                      | 6.1                                    | 295  | 107   | 29.0  | 7.4             | 63.6                      | 56.1          | 0.3                                |
| Saint Kitts and Nevis                   | 5.5                                    | 667  | 414   |   | 62.1            | 37.9                      | 37.9          | -                                  |
| Saint Lucia                             | 5.0                                    | 306  | 209   | 53.1  | 15.3            | 31.6                      | 31.6          | -                                  |
| Saint Vincent and the Grenadines        | 5.9                                    | 340  | 223   |   | 65.5            | 34.5                      | 34.5          | -                                  |
| Suriname                                | 8.6                                    | 385  | 161   | 32.5  | 9.3             | 58.2                      | 35.9          | 0.2                                |
| Trinidad and Tobago                     | 3.7                                    | 428  | 160   |   | 37.3            | 62.7                      | 53.8          | 4.7                                |
| Uruguay                                 | 10.0                                   | 805  | 234   | 13.4  | 15.6            | 71.0                      | 17.8          | 53.3                               |
| Venezuela (Bolivarian Rep. of)          | 4.9                                    | 272  | 128   | 32.5  | 14.4            | 53.1                      | 46.3          | 2.2                                |
| Latin America and the Caribbean average | 6.6                                    | 438  | 241   | 40.8  | 13.9            | 45.3                      | 36.8          | 7.4                                |
| World average                           | 6.2                                    | 640  | 436   | 45.2  | 13.0            | 41.9                      | 34.6          | 4.0                                |
| OECD, high-income countries             | 8.9                                    | 2 514  | 1 808   |   | 72.5            | 27.5                      | 19.5          | 5.3                                |

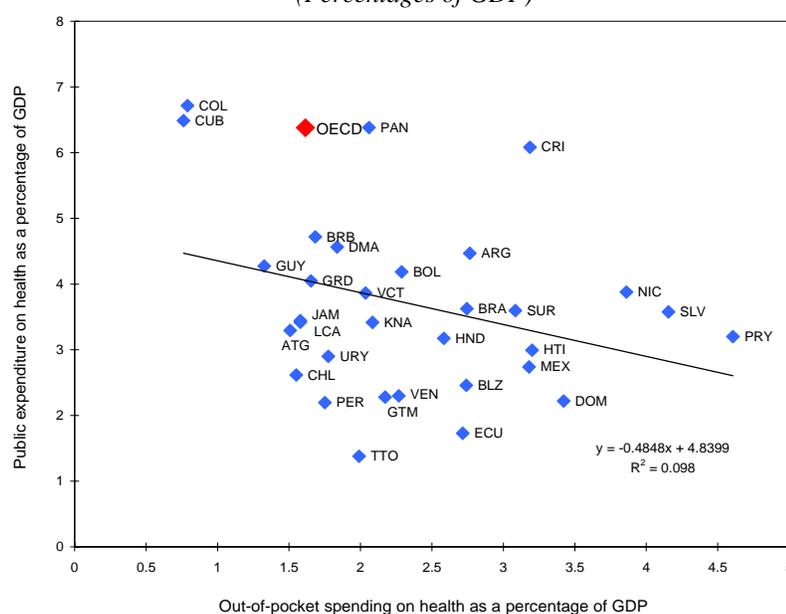
Source: World Health Organization (WHO), *The World Health Report 2005*, Washington, D.C., 2005.

<sup>5</sup> Insofar as health expenditure involves an increasing tradable-goods component, expenditure in relation to GDP loses precision as a comparator. This is because changes in the relative prices of tradable and non-tradable goods can significantly affect the volume of resources that countries must allocate to health goods and services. For a country whose currency is not the dollar, devaluation raises the cost of consuming imported goods, so additional resources are needed to buy a similar volume of tradable goods. This is particularly true in the case of imported medicines, medical equipment and inputs.

Nonetheless, when the comparison is made in terms of per capita expenditure, which indicates the absolute level of resources allocated to the sector, the region is below the world average (US\$ 438 per person as opposed to US\$ 640), and well below that of high-income OECD countries (US\$ 2,514).

Furthermore, the region's relatively low level of health expenditure is largely funded by families themselves, through out-of-pocket payments. Whereas family contributions represent roughly 20% of total expenditure in developed countries, in Latin America and the Caribbean the figure is 37% on average and rises above 50% in several cases. This partly reflects levels of expenditure on the public and social-security systems. As figure III.3 shows, countries that report lower social spending on health tend to report higher out-of-pocket expenditure in relation to GDP. With very few exceptions, the region's countries display lower levels of public expenditure and higher out-of-pocket spending than high-income OECD countries.

Figure III.3  
PUBLIC EXPENDITURE AND OUT-OF-POCKET SPENDING ON HEALTH, 2002  
(Percentages of GDP)



Source: World Health Organization (WHO), *The World Health Report 2005*, Washington, D.C., 2005.

Note: Public spending in the chart refers to consolidated spending of the government and social security system. The OECD data represent the unweighted average of the organization's 24 high-income member countries.

The need to incur out-of-pocket expenses to gain access to health services or consume medicines is a major source of inequity (Titelman, 2000). In fact the WHO report classifies inequity among countries as regards health by the proportion of total expenditure on health represented by out-of-pocket payments (PAHO, 2002). On this basis, the figures quoted above portray the region's health systems as highly inequitable. The sharp inequity inherent in the high level of out-of-pocket spending is also clearly reflected in the proportion of family expenditure allocated to the consumption of health goods and services, which tends to be larger among lower-income families (see table III.3). This type of expenditure also has a highly impoverishing effect on households, especially when exceptionally large or "catastrophic" health expenditures are involved (Knaul and others, 2003). Out-of-pocket spending on health is also gender-biased: in four of the region's countries, women spend between 16% and 40% more on health than men do (Gómez, 2001). Lastly, medicines are the largest item in total household expenditure on health. In view of this situation, and the high cost of certain treatments, some of the region's countries have devised a variety of strategies to broaden access to medicines, including the use and promotion of generic drugs (see box III.3).

Table III.3  
**HOUSEHOLD EXPENDITURE ON HEALTH AS A PERCENTAGE OF HOUSEHOLD  
 CURRENT INCOME**  
*(By household income quintile)*

|                       | Quintile |      |      |      |         | Total | Q1/Q5 |
|-----------------------|----------|------|------|------|---------|-------|-------|
|                       | Poorest  | 2    | 3    | 4    | Richest |       |       |
| Chile <sup>a</sup>    | 2.16     | 1.79 | 1.86 | 1.89 | 1.75    | 1.89  | 1.24  |
| Mexico <sup>b</sup>   | 4.22     | 3.17 | 2.71 | 2.91 | 2.82    | 3.17  | 1.50  |
| Paraguay <sup>b</sup> | 6.99     | 5.06 | 4.31 | 4.67 | 4.25    | 5.04  | 1.65  |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys for the relevant countries.

<sup>a</sup> Refers to expenditure on medicines and related items, as a proportion of household income.

<sup>b</sup> Refers to ratio of monetary expenditure on health to total monetary income.

### Box III.3 USE OF GENERIC DRUGS IN LATIN AMERICA

The World Health Organization acknowledges that policy on essential medicines plays a strategic role in guaranteeing access to and rational use of pharmaceutical products. The countries of the region have adopted various strategies that recognize the importance of generic drugs in broadening access to medicines and obtaining accessible prices. Two policies that have had a major effect on the health of the respective population are examined here.

Argentina adopted a policy of prescribing medicines by their generic name or international common denomination (ICD), which refers to the active agent responsible for the drug's expected therapeutic effect. The aim of this policy is to reduce the impact of expenditure on health for families with the least purchasing power. This, along with the *Remediar* programme which provides free outpatient medicines for the poor and indigent, was a response to the economic crisis of 2002, but also served to increase price competition in the pharmaceutical market. Although the measure may also stimulate the creation of a market for benchmark generics, the market tends to incorporate such products only slowly. Encouraging the use of existing medicines by using their generic name is a highly cost-effective measure which can be implemented by prescribing the generic drug directly or by allowing pharmacists to substitute a product with another containing the same active agent. A recent study estimated that if half of the prescriptions issued in Argentina in 2002 had specified lower-cost commercial alternatives, the saving would have been around 20% of the country's annual expenditure on medicines (Tobar, 2002).

A second example of the use of generic drugs with a broad impact concerns the fight against HIV/AIDS in Brazil. In the late 1990s, the Brazilian government began local production of antiretrovirals and importation of generics not produced in the country, as a part of its successful policy to provide universal treatment for HIV/AIDS sufferers. The result of the initiative was a substantial reduction in the price of these drugs—from US\$ 6,240 yearly per patient in 1997 to US\$ 1,336 in 2004. The measure also had major impacts on public health, including fewer hospitalizations and a lower incidence of tuberculosis among AIDS patients. The policy is based on local technological capacity-building to manufacture antiretroviral drugs, and on direct negotiation with foreign pharmaceutical firms to secure lower prices for the medicines the country imports.

**Source:** Federico Tobar, "El uso de la farmacoeconomía y los desafíos de la regulación de medicamentos" [online] [www.remediar.gov.ar](http://www.remediar.gov.ar), 2002; Brazil, Ministry of Health, "The sustainability of universal access to antiretroviral medicines in Brazil", document prepared for the 157 meeting of the National Health Council, Brasilia, 10 August 2005; Argentina, Ministry of Health and Environment, "Política para la utilización de medicamentos por su nombre genérico", Buenos Aires, 2002.

As will be discussed in this document, the financing structure of a health system is a key determinant of its equity and solidarity. The larger the public-sector component, the greater the redistribution implicit in the functioning of the health system. Public expenditure on health care is progressive, since a larger proportion of it is channelled to the poorest sectors (ECLAC, 2005a).<sup>6</sup> A larger proportion of out-of-pocket spending, however, means less redistribution and greater

<sup>6</sup> Both the level of expenditure and its efficiency are important from a redistributive standpoint.

inequity. Conversely, the more developed social security is in terms of health-care delivery and financing, the greater, in principle, will be the coverage gap between formal workers and population groups that have access to the public-sector system only. This is also, however, a function of the degree of articulation between social-security and public health-care provision, as well as the level of funding of the public sector.

## Reform agenda: towards guaranteed universal coverage of health services

The foregoing analysis provides a basis on which to define a series of criteria, independently of national specifics, for the design of health-sector reforms and public policies on social protection in matters of health. First, the growing importance of non-communicable diseases, in conjunction with population ageing, suggests that countries will have to make progress in developing mechanisms to deal with more costly and complex pathologies. Second, given the need to deal with problems of social exclusion and inequity in health care, policies and instruments will have to be developed for the progressive universalization of coverage. Third, given the technological changes that have occurred in the health sector, constantly escalating costs and the projected growth in demand and financing requirements, measures to improve efficiency and contain costs have become crucial elements in health reforms and policies.

In order to improve real coverage of the population, health policies must strengthen and universalize the coverage of risk, so that the need to make out-of-pocket payments ceases to be a barrier to access to necessary treatment.<sup>7</sup> This means advancing in a balanced manner along two paths: the expansion of mandatory universal insurance systems and the strengthening of the traditional public health sectors.<sup>8</sup>

The proposed reform agenda, aimed at strengthening and expanding insurance against health risks, is built around the integration of financing among the systems, in order to attain greater solidarity. This section first analyses the difficulties posed by risk selection for the functioning of an insurance system and argues that the guaranteed coverage of such insurance must be defined explicitly. Second, it examines different ways of improving efficiency (cost containment), appropriate procurement mechanisms and the regulation of the system. Lastly, it argues that effective improvement of health-service coverage for the entire population requires public-health policies that make a priority of expanding primary care and properly coordinating decentralized services, including compensatory mechanisms to narrow gaps among regions.

### Policies for effective coverage of health risks

The organization of financing based on universal insurance schemes requires a number of elements to be defined. First, the relationship between the different sources of financing (general tax revenues, social-security contributions, and private expenditure) needs to be determined, since the degree of integration achieved will be the main determinant of solidarity and equity in health systems. Second, the mechanisms or instruments used to guarantee solidarity and prevent the problems of risk selection need to be explicitly defined. Third, the criteria for determining which services are to be covered by health insurance, particularly as regards universal coverage, need to be established.

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<sup>7</sup> An emblematic case is that of “catastrophic” illnesses that entail extremely high costs. Where these must be paid for directly (in the absence of adequate insurance mechanisms), a broad spectrum of the population either cannot obtain treatment at all or else suffers a financial impact of such magnitude that the household’s consumption of other basic goods and services is compromised.

<sup>8</sup> Insofar as health-related events are random and statistically independent, insurance schemes are an efficient way to organize financing. Nonetheless, the information asymmetries inherent in the sector, compounded by difficulties in measuring risks and the need to incorporate solidarity mechanisms, make the introduction of private risk-insurance schemes more complex in the health sector than elsewhere in the economy (Arrow, 1963; Atkinson and Stiglitz, 1980).

### Integration of health systems and insurance: towards integrated solidarity

Where health is concerned, solidarity can be said to exist when access to services is independent of people's contributions to the system or their actual ability to make out-of-pocket payments. This means that part of the population has to finance some (or all) of the costs of health services consumed by another part. In the reality of the region's health systems, the corresponding transfers can come from fiscal resources earmarked for public health-care systems or from contributions to the health-care segment of social-security systems.<sup>9</sup> The resulting solidarity may be classified as either integrated or segmented, according to the extent of integration between these two subsystems.<sup>10</sup>

Although contributory and non-contributory health-care financing take different forms and are interrelated in a variety of ways in Latin American and Caribbean countries, greater integration between social security and the public system can increase the synergies between the two, raising the level of financing available for solidarity purposes and enhancing equity. Furthermore, articulation between the social-security and public systems can have a positive effect on efficiency if integration leads to fuller utilization of installed capacity and rationalization of resource use through the improved management and administration of those subsystems.

However, admittedly, tax resources are scarce in most of the region's countries, and funds raised from social security contributions are major sources of health-care financing. In many cases, therefore, it would be unwise (or unrealistic) to suggest replacing contributory financing in the near future by sources that are difficult to collect. The primary goal is to achieve an equitable health system with solidarity-based financing. This can be achieved with funding that comes mainly from general revenues or through proper articulation of this source with social-security contributions.

As table III.4 shows, the region exhibits a wide variety of institutional mechanisms. A distinction can be drawn between those in which public health-care services are funded entirely from general revenues (type 1, primarily in the Caribbean and Brazil); systems with some degree of integration between contributory financing and general budgetary resources (type 2); and systems that lack such articulation (type 3).

For the purposes of this document, it is interesting to review the strengths and weaknesses of recent reforms designed to integrate public with social-security financing, either fully (as in Brazil) or through alternative types of articulation between contributory and non-contributory funding (type-2 systems). It is important to note that the different reform strategies reflect both the diversity and importance of each country's starting point: the specifics of each health system and its institutional setting produce different constraints and lead to different priorities that reform policies need to take into account.

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<sup>9</sup> Financing through external grants is becoming increasingly important in some of the region's countries, e.g. Haiti.

<sup>10</sup> This chapter focuses its analysis on the integration of health financing in the public and social-security sectors. In some of the region's countries, however, the social-security sector is not monolithic, in which case fragmentation among its various agents also poses a specific challenge. A distinction should be drawn between two concepts of solidarity: one defined in terms of risk and the other in terms of income. According to the former, two people with the same level of income but different health risks contribute the same amount of resources to the system, but the higher-risk individual will consume a higher level of services if necessary. In the second case, two people with different incomes but the same level of risk receive the same services but contribute as a function of their incomes.

Table III.4  
**LATIN AMERICA AND THE CARIBBEAN: COMBINATIONS OF PUBLIC FUNDING AND SOCIAL SECURITY CONTRIBUTIONS IN THE HEALTH SECTOR**

| Type 1  | Type 2  | Type 3   |
|---|---|--|
| Financing: general revenues, integrated systems based on non-contributory financing   | Financing: integration of general revenues and social security contributions  | Financing: little or no integration of general revenues and social security contributions  |
| <i>Services are structurally varied between public and private providers</i>  | <i>In all cases there is some degree of explicit separation between the financing and service delivery functions. The level of integration of financing also varies</i>   | <i>The structure of public services is heterogeneous, and different types of relationship exist between the public and private sectors</i> |
| <i>Public and private service provision: Bahamas, Barbados, Belize, Brazil, Dominica, Grenade, Guyana, Haiti,<sup>a</sup> Jamaica, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, Venezuela (Bolivarian Republic of)<sup>b</sup></i> | <i>Type 2A: Integrated, maintaining contributory financing and uniform set of services delivered via social security: Costa Rica</i><br><br><i>Type 2B: Integrated with coverage differentiated by contributory status: Antigua and Barbuda,<sup>c</sup> Colombia, Dominican Republic<sup>c</sup></i> | Argentina, Bolivia, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay                          |
| <i>Service provision through the public system only: Cuba</i>   | <i>Type 2C: Dual model with partial integration: Chile</i>  |  |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

**Note:** In all countries, except Cuba, there is also a private subsector that provides health services.

<sup>a</sup> In Haiti there is practically no social security, and the provision and financing of health services are undertaken basically by the public sector and non-governmental organizations (NGOs).

<sup>b</sup> The reforms of the last few years have elicited greater participation and coverage in the public system.

<sup>c</sup> Both Antigua and Barbuda and the Dominican Republic are in a transition period, implementing health reforms aimed at greater integration of financing.

### *Type 1: Integrated system based on non-contributory financing*

Apart from the Caribbean countries, most of whose health systems are integrated for historical reasons (see box III.4), Brazil provides an interesting recent example of a reform that facilitates non-contributory health-care financing. Under the 1988 Constitution, the right of workers to social security became a universal and integral entitlement to health care. Since then, Brazil has created a single public health system funded out of general revenues.<sup>11</sup> The new Single Health System (SUS) integrated the different social security schemes (except those covering the armed forces and police) so that the Brazilian system now consists of just two subsectors, the public and the private (see box III.5).

Although a reform of this type requires substantial tax collection capacity (notably, Brazil has the region's highest tax revenue-to-GDP ratio), the Single Health System provides an example of articulation between the public and social-security sectors, in which the former has virtually absorbed the latter, thereby making public health-care coverage universal.<sup>12</sup> As a result, on the basis of financing, closer integration of health care was achieved in conjunction with greater equity.

<sup>11</sup> Specific taxes have been introduced to finance social security within the framework of general tax revenues.

<sup>12</sup> Given the extremely serious funding crisis in the pension system, payroll deductions previously earmarked for health were redirected to the pension system, while tax revenues that otherwise would have been channelled into pensions went to the single health system.

Box III.4  
**SYSTEMS INTEGRATED FROM THEIR INCEPTION: HEALTH CARE  
 IN THE CARIBBEAN**

For historical reasons, including colonial heritage in English-speaking countries, or for reasons of scale, a vertically integrated public health sector is the most common scheme in the Caribbean, with the private sector insuring or providing services to a relatively small proportion of the population (the Cuban case can be viewed as a variant of this type in which provision is exclusively public).

Generally speaking, the public sector bears chief responsibility for health service provision, regulation and financing, with no explicit separation between its procurement, insurance and service-delivery functions. The sole exception among the Caribbean countries is the Dominican Republic. The financing of the public system is essentially non-contributory, based on budgetary appropriations and, in some cases, earmarked taxes.

The private sector generally plays a supporting role by providing health services and bringing funds into the system. In some countries, this sector is still incipient, while in others it has grown substantially (Cercone, 2005).

The increasing importance of private insurance and health-service providers, in conjunction with the ever higher level of out-of-pocket payments and the effects of rising costs in the public system, is pushing the subregion (apart from Cuba) towards a model in which the wealthiest members of the population seek their health care abroad, middle-income groups use private insurance or services, and the poorest rely on the public system (CCHD, 2006). Reversing this trend and implementing effective mechanisms to contain the rising costs of health systems are the greatest challenges facing Caribbean countries in terms of equity and access to health services.

Given that costs are set to rise strongly in the Caribbean countries in the future, basically as a result of the increasing prevalence of cardiovascular diseases, obesity and HIV/AIDS (PAHO, 2005b), several reform proposals have been made to integrate the system by establishing national health insurance schemes, with a view to finding alternative sources of funding and making administration more efficient. Bahamas, Belize, Jamaica, Trinidad and Tobago, Saint Lucia and Saint Vincent and the Grenadines, among other countries, are either at the preliminary stages of debate or starting to introduce national health insurance plans of various types (CCHD, 2006).

Caribbean countries are well placed to undertake a reform of this type, because they have relatively strong public systems for historical reasons, and do not face problems of segmentation between the public and social-security subsystems. These insurance schemes could be funded either from general revenues or through a system of specific worker and/or employer contributions, but steps must be taken to ensure that this does not create a social insurance scheme independent of the public sector, which would segment the system.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

Box III.5  
**PUBLIC AND PRIVATE PROVISION IN BRAZIL**

The Brazilian State offers free universal coverage to the entire population under its Single Health System (SUS). This system is intended to distribute public resources in an equitable manner, as reflected in the fact that most of the population (but particularly the poorest groups) use the services of SUS. According to estimates quoted by Medici (2002), 40% of the population relies on this system exclusively and 44% uses it on a complementary basis, although SUS accounts for only one third of total health expenditure. Federal, state and municipal governments are all responsible for providing health care services, and a significant fraction of SUS units outsource services to the private sector, which is resulting in a process of gradual decentralization. The federal government's share of public health service financing fell from 73% in 1985 to 54% in 1996, while the municipal share grew from 9% to 18%. In 2003, the federal government funded 50.7% of SUS, with the states contributing 22.8% and municipalities 26.5%.

Public employees are a special case, since they are given an allocation to take out private insurance policies while retaining their right to care under SUS. The armed forces and the police are covered by their own programmes, which are separate from SUS.

Use of private health services is voluntary. The private subsector plays a complementary role and is regulated and overseen by the federal government. It is used by medium- and high-income groups, who obtain additional coverage through prepayment arrangements, medical cooperatives or insurance reimbursement plans. Many large firms offer health plans, which are generally outsourced to private insurers; nonetheless, much of the privately insured population uses SUS services, especially for complex and costly health events.

**Source:** A. Medici, *Financing Health Policies in Brazil. Achievements, Challenges and Proposals*, Washington, D.C., Inter-American Development Bank (IDB), 2002 and Pan American Health Organization (PAHO), "Brasil: O perfil do sistema de serviços de saúde", Latin America and Caribbean Regional Health Sector Reform Initiative, Washington, D.C., 2005.

*Type 2A: Integrated system maintaining contributory financing and a uniform set of services under social security*

Costa Rica provides another example of integration between the public and social security subsystems. Unlike Brazil, however, this country maintained payroll contributions to the Costa Rican Social Security Fund (CCSS), known as the *Caja*, which also receives support from tax revenue to cover individuals who are unable to make contributions. The *Caja* is the main health-system institution today; it provides services of varying complexity and has also been responsible for primary care since 1995.

The *Caja* operates as an insurance scheme, providing uniform coverage to all its affiliates. The State provides funding basically at three levels: first, it tops up the contribution made by employees and employers (with a relatively small amount); second, it covers roughly 50% of the contributions of self-employed workers and those who are voluntarily insured, thereby partly assuming the employer contribution;<sup>13</sup> and third, it pays 100% of contributions for the poorest groups who lack the capacity to contribute.<sup>14</sup>

Integration of the different income groups—who use the same facilities and receive the same services—has been the key to the success of Costa Rica’s health policy. Nonetheless, over the last decade wealthier people have tended to prefer private services for primary and specialized consultations rather than use the public system. Although this group maintains its contributions to social insurance, which means that the solidarity of the system is not undermined, it does create incentives to evade contributions (Rodríguez, 2005b).

While Costa Rica offers an interesting example of integration between public and social-security financing in the framework of a relatively simple insurance scheme, other reforms undertaken in the region have entailed integration through mechanisms that are institutionally more demanding.

*Type 2B: Integrated system with differentiated coverage by contributory status*

Colombia’s health-care reform has retained a major contributory financing component, alongside traditional financing based on tax revenues. The two sources are articulated by means of explicit solidarity mechanisms.<sup>15</sup>

Colombia’s reform was initiated in 1993 and it represents one of the region’s most complex efforts to move towards universal coverage through insurance schemes. It replaced the previous social-security and public subsystems with three regimes: a contributory plan for employees and self-employed workers earning more than twice the minimum wage; a subsidized scheme for informal workers and low-income self-employed workers; and a transitional arrangement to cover a group, referred to as the “*vinculados*”, who are not yet enrolled in the subsidized regime (see details in box III.6).

<sup>13</sup> The subsidy granted by the State to insure self-employed workers and the voluntarily insured does not depend on the beneficiaries’ income level, thus raising an equity issue, particularly in the case of independent professionals who would probably be able to pay both the employee and employer contributions. It also creates an incentive for many employers to have their workers figure as self-employed, since that relieves them of having to pay the employer contribution (Rodríguez, 2005b).

<sup>14</sup> Apart from income from payroll contributions, the Costa Rican Social Security Fund has a number of other revenue sources, such as the sale of lottery tickets and health services provided to people who are uninsured. This last source is negligible, however, and does not reflect the true magnitude of the institutions’ expenditure on the uninsured.

<sup>15</sup> The “Medical Benefits Scheme” in Antigua and Barbuda, which used to cover contributors only, was recently reformed to extend coverage to individuals suffering from a number of pathologies, irrespective of their contributions (CCHD, 2006). The health reform under way in the Dominican Republic stipulates universal coverage and the creation of three regimes: (i) contributory (for wage earners); (ii) subsidized-contributory (for self-employed workers with incomes above the minimum wage); and (iii) subsidized (for self-employed workers with incomes below the minimum wage, the unemployed, disabled and indigent). See Mesa-Lago (2005) for further details.

Box III.6  
**THE COLOMBIAN REFORM**

The health reform in Colombia created two regimes, the contributory and the subsidized, along with a transitory scheme to cover individuals not yet affiliated (known as *vinculados*). Members of the armed forces, the teaching profession and employees at the State oil firm were excluded from the new regime and continue to be covered by their pre-existing schemes.

The contributory regime provides mandatory coverage to workers in the formal sector, both employees and own-account workers who earn more than twice the minimum wage and pay contributions. This coverage also extends to their family dependants and to pensioners. The contributory regime is structured around Health Promotion Agencies (EPSs), which are responsible for promoting and undertaking insurance, as well as organizing and guaranteeing the delivery of health services included in the compulsory plan. All Colombian workers (employees or otherwise) are required to enrol in an EPS. Self-employed workers contribute 12% of their earnings, while employees pay only one third of this, with the other two thirds being covered by their employers. The contributions collected are divided into three categories: (i) one percentage point of the 12% is earmarked to help fund the subsidized regime; (ii) the capitation payments received from workers and their families are channelled to the EPSs; and (iii) a portion is used to cover affiliates' work-related disabilities. Any surpluses generated after deduction of these payments from the total contribution are added to the 1 percentage point that goes directly to the solidarity and guarantee fund, for redistribution through solidarity mechanisms with the subsidized regime and the contributory regime's risk compensation fund. These two mechanisms are fundamental for achieving joint financing and articulating solidarity-based funding.

The subsidized regime covers the low-income population that does not have capacity to contribute, such as informal own-account workers earning less than twice the minimum wage, together with the unemployed and their families. It is funded through transfers from the contributory regime, and from national government, departmental and municipal funds. Municipalities use the National Information System on Social Programmes Beneficiaries (SISBEN) to assess the living standards and sociodemographic characteristics of potential affiliates to the subsidized regime. Subsidized Regime Management Entities (ARSs) receive a subsidized capitation payment (UPCS) from the solidarity fund, which they use to provide their affiliates with the benefits set forth under the mandatory subsidized health plan (POSS). At the outset of the reform, such benefits were equivalent to at least 50% of the mandatory plan under the contributory regime, thus establishing a clear difference between the minimum services covered by the two subsectors. Services which, in principle, are not covered by the mandatory subsidized health regime have to be guaranteed by public hospitals.

Although coverage increased significantly after the reform, with insurance being extended to affiliates' families, the universal coverage targets for 2000-2001 were not attained. The reasons for this shortfall include the fact that the subsidized regime did not come into force until 1996. This was in addition to evasion, payment arrears and under-declaration of incomes in the contributory regime, and insufficient public expenditure. These factors have weakened the system's financial capacity to expand affiliation among the poor. The beneficiary information system (SISBEN) has also suffered from a number of problems. In fact, an individual's state of need is very hard to evaluate, which makes it difficult to identify potential beneficiaries. Lastly, expectations of labour market developments proved unrealistic, since the high level of enrolments anticipated among own-account workers has not materialized.

**Source:** Carmelo Mesa-Lago, "Las reformas de salud en América Latina y su impacto en los principios de la seguridad social", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

The reforms unified the mandatory contributions and benefits plans in each subsystem (with more extensive coverage of health services in the case of the contributory regime), made affiliation mandatory, and extended comprehensive health coverage to workers' families. In addition to establishing a mandatory health plan for the contributory regime and another for the subsidized regime, the costs of which are reflected in a risk-adjusted capitation payment unit, a basic State-funded health care plan was also established, free for the entire population. This is intended to cover public and community health activities relating to health promotion and disease control and prevention.

A new solidarity and guarantee fund was created to articulate contributory and non-contributory financing, and to fund the system's solidarity component. The fund has four sub-accounts: internal compensation (solidarity) within the contributory regime; solidarity with the subsidized regime; health promotion and disease prevention; and traffic accidents, terrorist attacks

and natural disasters. The reform also created new funding sources, through specific taxes and a share in oil revenues.

A reform model such as Colombia's requires great institutional capacity to regulate competition and ensure the proper functioning of solidarity and risk-adjustment mechanisms. Though not problem-free, this case is an example of an initiative that seeks to reconcile the goal of equitable access to health care with an explicit insurance system.

#### *Type 2C: Dual model with partial integration*

The Chilean case differs from those described above. It uses a different modality of articulation between the public and social-security systems, which may be construed as dual and partial. One of the key features of the reform begun in 1981 was segmentation, since mandatory health contributions can be paid to either of two health insurance systems that operate in parallel but have very different rationales. Contributors can choose between the National Health Fund (FONASA), which is a public health insurance scheme, and private health-insurance policies offered by health insurance institutions (known as ISAPREs) operating within the social security domain. If the mandatory payroll deduction (7% of the wage) is paid into FONASA, the contributor and his or her dependents become affiliated to the public health system. If the contribution goes to an ISAPRE, they are enrolled in the privately managed social-security health system and are covered by the health plans offered by these institutions according to the individual affiliate's risk and payment capacity. The plans specify degrees of coverage and types of benefits for the affiliate, individually or including his or her family group (spouse, children and other members), with no integration of financing across the subsystem.

Articulation between the financing of the public system and social security occurs only in the framework of FONASA, which is financed from the contributions paid by affiliates who choose its services, supplemented by contributions from general tax revenues (in the case of individuals who are unable to contribute). Insofar as it is jointly financed and access to benefits is independent of contributions, FONASA is the only institution to exhibit direct solidarity between contributors and non-contributors. In 2000 it was estimated that roughly 35% of the contributions made by higher-income members of FONASA went to finance services received by non-contributors (Bitrán, 2000). Hence, this subsector exhibits solidarity of both risk and income.

Despite the existence of income solidarity in FONASA, the duality of the system and the individual nature of insurance in ISAPREs create obstacles to full integration of financing and to greater equity. Higher-income individuals tend to enrol in the ISAPRE system, especially at the stage of the life cycle in which health risks are relatively low; so they pay high contributions and carry low risk but do not participate in contributory solidarity mechanisms.

#### *Type 3: Non-integrated systems*

Lastly, there is a large and varied group of systems with little or no articulation between public financing and social security. In these countries (type 3 in table III.4) highly fragmented social-security systems coexist with a multiplicity of institutions that lack coordination mechanisms and have little in the way of solidarity financing. The public sectors in these countries provide varying degrees of coverage, accessibility and quality. Despite many attempts at integration, substantial systemic progress has yet to be achieved in these countries, although a number of initiatives are now underway (box III.7 describes an example of this type in Mexico).

## Box III.7

**PEOPLE'S HEALTH INSURANCE IN MEXICO: SUBSIDIZED VOLUNTARY INSURANCE FOR NON-CONTRIBUTORS TO SOCIAL SECURITY**

Mexico has developed a range of public health programmes for the poor, of which the Mexican Social Security Institute's *Oportunidades* scheme (which is examined in detail in chapter V) is the most prominent. Generally speaking, public health programmes in Mexico have focused on service delivery and primary care. The *Seguro Popular de Salud* (SPS) has some innovative features with respect to previous initiatives, partly because of its emphasis on demand subsidy and partly because of its funding modality.

One of the innovations of SPS is that it subsidizes demand for the poorest segments of the population, whereas prior to this the federal ministry's programmes had tended to subsidize supply. SPS is run under the auspices of the ministry in collaboration with the States. It targets the poor and consists of a package of free benefits (which have risen gradually in number from 78 to 91). SPS covered two million people, or 2% of the population, in 2004 and is intended to encompass 10% by 2010. SPS does not discriminate by risk or pre-existing conditions, as other voluntary public insurance plans do. One of the programme's key objectives is to reduce out-of-pocket expenditure, which constitutes 52% of health care spending and has a disastrous impact on the poorest families. The two lowest income quintiles, which represent 94% of those covered by the insurance, receive the package free of cost. In 2002, 40% of the cost of the package corresponded to medicines and 27%, to preventive and curative care.

With regard to financing, no payment is required from the 94% of beneficiaries who fall into the two lowest income quintiles. The other 6% pay a scaled premium set by socio-economic level. In 2004, 68% of the system's funding came from the federal government, 29% from the States (with significant differences from one State to another) and 3% from beneficiaries. Because of political difficulties involved in changing traditional budget allocations, the new demand subsidies are drawn from "fresh" federal funds created by the insurance, with 39% of federal contributions representing new transfers and 29%, funds that the States were already receiving.

SPS is well-rated by its beneficiaries. It is deemed to have made care more equitable and to have reduced the poor's out-of-pocket health care expenditures by 25%, especially on medicines. A number of challenges remain, however. For the system to work, the geographical areas to be covered need a minimum of infrastructure and there are serious obstacles to covering population groups outside accessible areas. The major socio-economic and cultural differences within the target population present significant challenges as well. Lastly, SPS needs a large (and increasing) amount of investment if it is to be financially sustainable while reaching its coverage targets and funding the rising costs associated with population ageing, epidemiological change, growing user demand and the expansion of the package.

**Source:** G. Nigenda, "El Seguro Popular de Salud en México: desarrollo y retos para el futuro", *Nota técnica de salud*, No. 2/2005, Washington, D.C., Inter-American Development Bank (IDB), 2005 and C. Mesa-Lago, "Las reformas de salud en América Latina y su impacto en los principios de la seguridad social", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

**Insurance and risk selection**

Depending on regulatory frameworks and rules governing contributions, the creation of insurance schemes can create major incentives for insurers to engage in risk selection, or "cream-skimming", which can seriously detract from a system's equity and efficiency and undermine its ability to provide a universal and uniform health care package. In order to reduce incentives to skim, it is important to base insurance premiums on population risk, rather than individual risk. Risk-adjustment mechanisms should also be used, in the form of cross-transfers that are tailored to each insurer's risk structure and regulated by a central body. The most commonly practised adjustments are for income, sex and age, creating greater solidarity between social sectors, genders and age groups.

In Colombia, difficulties in expanding coverage have been exacerbated by incentives for risk skimming by the insurance providers in the contributory and subsidized regimes. This pattern has occurred despite measures taken to avoid it, such as adjustment of capitation payments for age, sex and by members' and beneficiaries' geographical location (in order to cover the higher costs associated with remote areas and zones of armed conflict) and allowing insurers to charge moderate co-payments and premiums and thus promote the rational use of services. Incentives to skim are created by differences between the obligatory plans of the contributory and subsidized regimes, on

the one hand, and the existence of a poor population not affiliated with either (the *vinculados*), which has access to health care through public hospitals funded by general revenues, on the other (Mora, 2000).

In Chile, the public proposal to continue the reform process, which led to the changes begun in 2003, was directed at enhancing the aggregation of health risk in the population by means of a risk-adjustment mechanism. This fund, had it been approved, was intended to financially link the whole social security system (ISAPREs plus FONASA contributors) with the public sector, in order to avert inefficiency and risk problems and build up solidarity in the system (see box III.8).

### Box III.8

#### CREAM-SKIMMING AND RISK SELECTION IN CHILE

The income and age distribution of the population in the public and private subsectors shows the majority of people in the four lower quintiles affiliated to the public system. A majority belong to ISAPREs only in the fifth quintile (the wealthiest 20% of the population). This pattern was observed throughout the 1990s. Meanwhile, age distribution patterns show that older people tend to belong mainly to the FONASA system. Even among the wealthiest 20% of the population, the majority of those aged over 50 years are registered with FONASA.

Insofar as older people represent a higher medical risk, the rationale of private insurers tends to lead insurance companies to discriminate against them, either through premiums or by reducing coverage levels. Risk discrimination affects not only older people, but anyone at greater risk of illness, such as sufferers of chronic conditions and lower-income individuals, who represent “bad risks” from the private insurer’s point of view. Thus, ISAPREs, acting as risk insurers in a highly deregulated market, tend to practice risk discrimination. The existence of FONASA, as a solidarity-based insurer of last resort, combined with the freedom of the ISAPREs to engage in risk selection, has made access to health care a function of income and probability of illness in the Chilean model. FONASA tends to group a high proportion of low-income groups with greater medical risk, whereas the ISAPREs attract high-income, low-medical-risk individuals. This segmentation of the population is a consequence of Chile’s particular combination of public and private components, and works to the detriment of the system’s equity. In order to reduce the risk-selection problem, it was proposed to create a risk-adjustment fund to distribute resources between the ISAPREs and FONASA according to their risk portfolios. However, political factors prevented the measure from being approved, so that direct solidarity between contributors and non-contributors is still limited to the FONASA subsystem.

| Age group   | Quintile 1    |         |           | Quintile 2    |         |           | Quintile 3    |         |           | Quintile 4    |         |           | Quintile 5    |         |           |
|-------------|---------------|---------|-----------|---------------|---------|-----------|---------------|---------|-----------|---------------|---------|-----------|---------------|---------|-----------|
|             | Public sector | ISAPREs | Remainder |
| 0 - 20      | 92.2          | 1.6     | 6.2       | 85.8          | 6.6     | 7.7       | 73.5          | 15.2    | 11.4      | 53.8          | 32.0    | 14.3      | 26.2          | 61.6    | 12.2      |
| 21 - 50     | 89.0          | 1.7     | 9.3       | 82.6          | 6.2     | 11.2      | 72.5          | 12.9    | 14.7      | 55.3          | 26.8    | 17.9      | 31.1          | 52.1    | 16.8      |
| 51 - 64     | 91.6          | 1.1     | 7.3       | 90.7          | 2.3     | 7.0       | 82.4          | 6.5     | 11.1      | 70.6          | 14.1    | 15.3      | 44.5          | 40.6    | 14.9      |
| 65 and over | 93.2          | 0.8     | 6.0       | 93.7          | 1.0     | 5.3       | 90.2          | 1.7     | 8.1       | 82.2          | 5.6     | 12.2      | 58.7          | 22.0    | 19.3      |
| Total       | 91.0          | 1.6     | 7.5       | 85.5          | 5.6     | 8.9       | 75.7          | 11.8    | 12.5      | 59.8          | 24.4    | 15.9      | 34.6          | 49.9    | 15.6      |

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Argentina is now creating adjustments for age and sex within its subsidy system in order to ensure coverage of the mandatory health plan for the lowest-income beneficiaries of the social security system (*obras sociales*). This move would be progressive, as resources become available to cover the different risks. Since the country has a targeted programme for the older population, the adjustment will be most relevant to risk selection among the economically active population.

#### Explicit definition of coverage

The universal right to health care is enshrined in the legislation of virtually all the Latin American and Caribbean countries. In the absence of guaranteed commitments and adequate public funding it is difficult to have the entitlement to that right respected, however, and it is often rationed through waiting lists of uncertain duration, with non-transparent criteria for defining hierarchies of pathologies.

One way to defend the enforceability of rights and deal with funding problems and inequity is to create universal, explicitly guaranteed packages of services (see table III.5). Such required treatment packages or plans must be available to the entire population, regardless of risk or income. The choice of benefits to be included in this type of package should be guided by the health needs of the population as a whole. In cases such as Chile's explicit health care guarantees (known as GESs), the guaranteed benefits plan has served to set priorities and channel resources towards the treatment of the pathologies that are most prevalent and cause most mortality and morbidity. In other cases, especially in the initiatives developed in Central America, the aim of the basic package and the guaranteed benefits has been to give excluded segments of the population access to primary care and to reduce epidemiological backlogs (Sojo, 2005).

Table III.5  
**LATIN AMERICA AND THE CARIBBEAN: UNIVERSAL EXPLICIT GUARANTEE PACKAGES, 2003-2004**

| Country                | Basic package of benefits  | "Catastrophic" illnesses |
|------------------------|--|--------------------------|
| Argentina              | Mandatory Emergency Medical Programme (PMOE)                         | Yes                      |
| Bolivia                | Basic Health Insurance (SBS)   | No                       |
| Brazil                 | Basic Health Care Plan (PAB)   | Yes                      |
| Colombia               | Mandatory Health Plan (POS), Mandatory Subsidized Health Plan (POSS) | Yes                      |
| Costa Rica             |  | Yes                      |
| Cuba                   |  | Yes                      |
| Chile                  | Universal Access Plan with Explicit Guarantees (AUGE)                | Yes                      |
| Ecuador (2003 project) |  | No                       |
| Guatemala              | Integrated Health Care System (SIAS), limited                        | No                       |
| Haiti (2004 project)   |  | No                       |
| Mexico                 | People's Health Insurance (SPS), partial                             | Partial                  |
| Nicaragua              | Very limited   | No                       |
| Panama                 | Limited  | Partial                  |
| Peru                   | Comprehensive Health Insurance (SIS), partial                        | No                       |
| Dominican Republic     | Basic Health Care Plan (PBS), partial                                | Partial                  |
| Uruguay                | Not defined  | Yes                      |

**Source:** Carmelo Mesa-Lago, "Las reformas de salud en América Latina y su impacto en los principios de la seguridad social", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

The composition of the guaranteed benefits package arouses much political and technical contention, but is of prime importance for making an insurance system work and key to its funding needs. It is no easy task to define the subset of benefits that will be covered and guaranteed for an entire population. Indeed, it touches on issues of citizens' rights, as well as ethical dilemmas concerning health protection. Generally speaking, it convokes a wide-ranging social debate involving a variety of ethical, political, cultural, medical and economic matters.

The definition of a set of benefit entitlements is a useful way to facilitate insurance coverage, since it explicitly lays out the benefits to be financed and helps set prices for the different services. In addition to providing an organizational tool and reflecting budgetary constraints, the purpose of creating a package of universal, guaranteed rights is not to reduce individual coverage but to

guarantee a level of coverage that is enforceable and, in principle, the same for all. These packages should be seen, not as a rigid structure, but as a way of setting priorities that can be gradually extended. Lastly, health care priorities must not be allowed to crowd out conditions that are not part of the package, and this means that care needs to be taken to ensure that the package's coverage does not absorb the entire capacity of the public system.

When a society establishes a benefit package to which all its citizens are entitled and people are effectively able to demand and receive that package, it automatically creates a long-term financial obligation. Insofar as the system is funded by contributions and general revenues, entitlement to benefits creates contingent liabilities for the public sector. In other words, by creating an enforceable social right, the State undertakes an obligation to guarantee it. In practice, this means funding it and providing legal mechanisms by which citizens can exercise their right to have it enforced. In order to fund contingent liabilities, the State has to create financing rules to guarantee the provision of benefits and maintain fiscal discipline. In turn, the capacity to meet contingent liabilities is seriously affected by business cycles. The behaviour of contingent liabilities plays a pivotal role in financial sustainability, too. For example, the expansion of guaranteed coverage must be undertaken according to rules and criteria that ensure the higher benefits' compatibility with the effort to keep social spending patterns fiscally sustainable over time and to strengthen the actuarial component of the social protection system (Titelman and Uthoff, 2005).

Given the countries' limited capacity to fund social protection, the region's basic packages of entitlements should be construed as a means of advancing towards integrated health care systems that provide timely, quality care to the entire population, regardless of risk and income. As the countries develop, prioritized packages should gradually expand as a function of the population's health needs.

### **Efficiency, organization and oversight of health care systems**

The problem of rising health care costs is very common in the countries of the region and elsewhere. As noted earlier, a combination of demographic, epidemiological and technological factors have generated demand for new products and processes that require greater financial resources. Meanwhile, information problems and other failures in the health-care market are compounding the structural tendency for system costs to rise. Expenditure on health has also been affected by the structural changes that have taken place in the delivery system, public and private alike. The increasing use of new technologies —especially the introduction of electronics to traditional mechanical processes and biotechnologies employed in the production of pharmaceuticals— can improve diagnostic procedures and help solve health problems, but it also moulds a service delivery model that tends towards highly complex procedures, not entirely compatible with the basic needs of population groups who are less advantaged as regards income distribution (Katz and Miranda, 1994). Liberalization-favouring economic approaches have encouraged the incorporation of such technologies and, hence, the adoption of more sophisticated benefits models that, in turn, push up costs. Later economic adjustment processes have also contributed to raising costs —through the higher cost of imports— and increasing exclusion (Bisang, 2005).

Reforms should therefore be directed towards improving the industrial organization and the regulation of the health sector, in order to increase efficiency and help contain costs. This section will consider recommendations regarding the separation of the funding and delivery functions, the creation of efficient procurement mechanisms and the establishment of a regulatory framework capable of dealing with the numerous market failures that occur in the area of health, seeking to promote equality and efficiency.

## Separation of functions

The adoption of insurance systems makes it easier to separate financing from service delivery in health care. It can also generate incentives for cost savings, through the articulation of public and private service providers. In the context of the health sector, the function of insurance providers should not be confined to paying out on insured events. In other words, they should not act merely as payment dispensers but as health-risk administrators and they should be actively involved in the purchase of health services for their subscribers. By acting as efficient buyers on behalf of their subscribers, insurance providers can mitigate the problems of information asymmetries between providers and consumers, which in turn reduces the problems of induced demand. This also facilitates the development of payment mechanisms that encourage rationalization of resource use since, as institutional buyers, insurance providers can encourage the progressive adoption of the capitation mechanisms discussed below.

There is a mounting consensus regarding the benefits of separating health care funding from delivery (Frenk and Londoño, 1997) and several countries in the region and elsewhere have been moving in this direction, both in primary care and at the secondary and tertiary levels. Regardless of the institutional arrangements employed to separate the functions (independent institutions, as in Colombia, or different entities within a single institution, as in Costa Rica), this approach makes it possible to provide incentives that, in a proper regulatory framework, encourage rational and efficient use of health-sector resources.

A number of the region's countries have taken steps to separate the two functions. The Central American countries have done so in primary care through capitation contracts and performance targets with NGOs. Nicaragua is perhaps an extreme example at the level of secondary care. The Nicaraguan Social Security Institute (INSS) covers 6% of the population and in 1994 began to outsource the delivery of all its members' benefits to public and private medical providers (EMPs).<sup>16</sup> In Brazil, 70% of the hospital services provided under the Single Health System are outsourced to private providers.

Colombia's 1993 reform sought to separate insurance from service provision, while also shifting from supply-side to demand-side subsidization. The insurance companies in both the contributory regime (known as ARSs) and the subsidized regime (EPSs) purchase services from Service Delivery Institutions (IPSSs), which may be either public or private entities. Public hospitals therefore became State-owned social corporations with a legal personality, equity capital and administrative autonomy.

Importantly, the separation of functions does not necessarily imply the introduction of demand subsidies. Such subsidies are warranted as part of strategies to increase the consumer's capacity to choose among providers of both insurance and health services. However, an international review of initiatives shows that such subsidies do not necessarily make spending allocation more efficient, given the features of the health sector itself and governments' limited institutional capacity to implement them. In view of the problems of information asymmetry and induced demand in the health care market, consumer sovereignty is not easy to exercise. It is difficult for patients (as consumers) to make efficient use of the subsidies. Hence, the problems of inefficient resource allocation in supply-side subsidies are often reproduced in demand-side subsidies where the market suffers from incomplete information. There are also institutional constraints on the administration, collection and calculation of subsidies. For example, the formula used to determine risk-adjusted payments under the Colombian reform considers only age and sex,

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<sup>16</sup> EMPs are responsible for providing a package of services to directly insured individuals. This includes care for almost 800 conditions, as well as general medical care for children under six years of age, and obstetric care for the spouses of direct members. INSS pays the EMPs on a uniform capitation basis, with no co-payments or limits on the number of times insured members may obtain service. The service provider may not segment benefits, but is obliged to provide all those included in the health care package. If it cannot, itself, provide a service required by INSS, it must subcontract it.

which are insufficient to predict risk in the absence of other factors such as area of residence and, hence, result in inadequate subsidy calculation (Mora, 2000).

The Costa Rican reform of 1998 offers an example of a useful mechanism for combining separation of functions with supply-side subsidy. The Costa Rican Social Security Fund created a mechanism to allocate resources as a function of outcomes. Service procurement is based on a performance agreement or contract, which formalizes the relationship between the Social Security Fund and the service providers (see box III.9). The corresponding procurement process has been consolidated only slowly, however, since the budget continues to be structured largely along historical lines, with only a small fraction depending on the outcomes of the annual performance reviews (Rodríguez, 2005b).

### Box III.9

#### COSTA RICA: PERFORMANCE AGREEMENTS

The performance agreement (*compromiso de gestión*) is a contract formalizing the relationship between central authorities and service providers, recently implemented by the Costa Rican Social Security Fund. Under this arrangement, hospitals commit to reaching a series of targets which are defined in terms of “hospital production units,” and a percentage (originally 10%) of the annual budget was to be allocated as a function of their outcomes, as set down in annual performance appraisals. This percentage was intended to increase over time, so that all production would ultimately be rated and the former budget arrangement would be phased out. Moreover, 10% of the budgets of the “health areas” (intermediate entities covering specified geographical areas) was also to be allocated on the basis of outcomes, in this case based on a capitation model in which the per capita amount would be weighted by the demographic and epidemiological characteristics of the population covered. Originally, hospitals were to bill the health areas for the cost of patients referred to them by Basic Integrated Health Care Teams (EBAISs). Thus, primary care teams would have an incentive to resolve cases directly without referral, which would enhance primary care treatment capability. Flaws in information systems prevented this from working, however. The original proposition also included a system of rewards and sanctions based on providers’ performance as measured against the targets set out in the respective agreements.

In order to support performance agreements, mechanisms were created to engage citizens in the management and oversight of health services, mainly in the form of Health Boards composed of directly elected community representatives. Every hospital, major clinic and health area has its own Board, whose main responsibilities are to oversee budget execution and other management activities; the selection of directors and the contents of performance agreements; and performance outcomes. In addition, they are expected to undertake health promotion activities and projects in the community, especially in the area of environmental health. The Social Security Fund provides physical facilities and administrative support for the Boards’ activities.

Despite these advances, the process has moved slowly and a comprehensive evaluation is needed to redefine it. In the first place, a broad range of human resources and administrative outsourcing competencies were to be transferred to hospitals and health areas, but in practice this occurred on a much less ambitious scale than had been planned. Second, the performance agreements began to be drawn up by the administrative division of the Social Security Fund. This created a dichotomy in terms of the strategic direction of the service network, since the Fund’s medical division was developing strategic and operational plans in consultation with the network’s providers, who were meanwhile focusing on the targets established in the performance agreements drawn up in negotiations with the administrative division, the fulfilment of which had a direct impact on their budget. Also, the agreements became unduly long and detailed, to the point of defining protocols that did not coincide with the standards set by the Ministry of Health, with damaging effects on the appraisals conducted by the Ministry in its capacity as the system’s watchdog. Third, a budgetary system truly linked with the outcomes of the service network was never really developed. Basically, the budget continued to be generated as before, with only a very small portion of disbursements depending on the outcomes of the annual performance reviews. Fourth, the agreements lack economic and financial agreements to build one very important factor into the network’s priorities, namely, a cost-containment mechanism that would ensure the sustainability of the health insurance system.

**Source:** Adolfo Rodríguez, “Reforma de salud en Costa Rica”, work document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

### Health service procurement mechanisms

The main advantage of separating functions is that it makes it possible to create incentives for the institutions that manage a system's financial resources (ministries of health, social security institutions and private insurers) to improve and streamline the capacity and management of their health services procurement processes.

The rationalization of procurement requires the use of payment instruments that transfer some of the financial risk to service providers as a function of projected demand profiles and levels. "Prospective payment mechanisms", as these are known, including capitation, point in that direction, since they allocate the entire risk of cost variability to providers (Alvarez, Pellisé and Lobo, 2000). The main difference between these mechanisms and retrospective payment arrangements (which are based on the actual services delivered) is that prospective payments to the provider do not vary according to the number of services provided, whereas retrospective payments do. In a retrospective arrangement, the financier bears all the risks inherent in cost variability. Thus, payments for services rendered tend to encourage overproduction in health services, while prospective mechanisms create incentives for underproduction and declining quality (Erazo, Castro and Hanzich, 2005).

In the light of this, though prospective mechanisms promote efficiency and cost containment, they tend to encourage a lowering of the quantity and quality of services. Indeed, the number and quality of services are the provider's only parameters for aligning revenue with production costs. On the other hand, retrospective payment entails problems of induced demand and moral hazard, thereby encouraging overproduction of services and increasing costs.

Experience suggests that health care systems operate best with an appropriate combination of the two mechanisms. Table III.6 shows the basic types of payment systems and their effects on the quality and efficiency of the services provided. Ideally, the method chosen should be the one most appropriate to each situation, so that the payment unit chosen is the one that best suits the financing organization and risks are distributed between this organization and the provider in such a way that the latter bears the risks associated with the greater or lesser efficiency of service provision (Alvarez, Pellisé and Lobo, 2000).

As indicated, a significant number of the region's countries have —albeit slowly— developed management and procurement models that employ prospective payment arrangements. One of the main problems encountered with this is institutional rigidity. Such rigidities have prevented ministries of health and social security institutions from freely performing their procurement role, on the one hand, and have constrained the capacity of public hospitals to adapt to this new type of contract, on the other. Difficulties in specifying service protocols have also slowed the progress of prospective payment arrangements. If public hospitals are to develop the flexibility they need to adapt to the requirements of a prospective system, changes are needed in their legal frameworks, management autonomy and human resources practices. Ministries of health and social security institutions should also be allowed to buy services outside the public sector, in order to make the best possible use of the country's installed capacity. This does not imply weakening the public hospital: in this case, as well as providing services, it plays a key role in establishing protocols and cost structures. It represents a benchmark and a discipline device for private providers in a context of yardstick competition. Nevertheless, as experience with autonomously managed hospitals in Argentina shows, there are legal obstacles and operational weaknesses in the path to full autonomy. In practice, hospital management may not have an entirely free hand in managing human and financial resources (Bisang and Cetrángolo, 1997).

Table III.6  
**BASIC TYPES OF PAYMENT SYSTEMS**

| Payment system                       | Concept   | Economic incentive   | Risk distribution   | Foreseeable effects  | Efficiency  | Quality | Role of government   |
|--------------------------------------|---|--|---|--|---|---------|--|
| Payment for medical services         | Payment is for most disaggregated service                                       | To maximize number of medical interventions                      | Financer normally assumes risk  | (i) Lack of prevention.<br>(ii) High-tech, good quality<br>(iii) Induced demand.<br>(iv) "Corruption"<br>(v) Rate discrimination<br>(vi) Inequality                  | Incentives for activity and over-use  | +       | Ceiling rates  |
| Wage-based payment                   | Payment is for time worked  | To minimize effort in work                                       | (i) Pure wage system: provider assumes risk<br>(ii) Adjusted for productivity: financer assumes risk  | (i) Importance of promotion<br>(ii) Staffing increases<br>(iii) Cooperation among physicians   | (i) May encourage activity and over-use<br>(ii) Physician's role amplified    | +<br>-  | (i) Weak negotiating power<br>(ii) Quality assurance<br>(iii) Design of mixed systems            |
| Per capita payment                   | Payment is for membership and services provided to the individual               | To maximize membership and minimize cost of service              | (i) Unadjusted per capita: provider assumes risk<br>(ii) Adjusted per capita: financer assumes risk   | (i) Prevention<br>(ii) Referral<br>(iii) Risk selection  | Encourages integration of care and preventive care when efficient             | -       | Quality control through standards and encouragement of competition                               |
| Payment based on hospital stays      | Hospital paid per patient-night   | To maximize number of stays and minimize average cost of stay    | (i) Where payment is not adjusted, provider bears the risk that stays will be costly<br>(ii) Where rates are adjusted to expected costs, financer assumes risk    | (i) Longer average hospital stay<br>(ii) Cost of hospitalization minimized<br>(iii) Unnecessary hospitalization admissions<br>(iv) Out-patient surgery not performed | Hospital activity encouraged  | -<br>+  | Limits on average hospital stay  |
| Payment based on hospital admissions | Hospital paid per patient admission, regardless of duration of stay             | To maximize number of admissions and minimize their average cost | (i) Where payment is not adjusted, provider assumes risk of costly admissions<br>(ii) Where rates are adjusted according to expected costs, financer assumes risk | (i) Higher revenues<br>(ii) Shorter average duration of hospital stays<br>(iii) Readmissions<br>(iv) Unnecessary hospitalization admissions                          | Encourages hospital activity  | -       | (i) Penalization of readmissions<br>(ii) Non-inclusion of extreme cases<br>(iii) Rate adjustment |
| Budgeted payment                     | Hospital paid for a given period of time, for activity that is not well-defined | To maximize costs  | Provider normally assumes risk if more specific factors are not taken into account  | (i) Costly implementation<br>(ii) Compatible planning<br>(iii) Provider has room for manoeuvre   | Encourages efficiency, except where there are serious information asymmetries | -       | Major effort required to avoid inertia   |

Source: B. Alvarez, L. Pellisé and F. Lobo, "Payment systems for health services providers in countries of Latin America and of the OECD", *Pan American Journal of Public Health*, vol. 8, No. 1/2, 2000.

Taking a different approach, an interesting initiative in Panama has combined a new type of hospital management with the pooling of financial resources between the Ministry of Health and the Social Security Fund, in the form of the Saint Michael Archangel Integrated Hospital (HISMA). The system pools available funds from the Ministry and the Social Security Fund and has helped to improve hospital management. HISMA is paid to supply a certain quantity and quality of services (the historical budget, which was independent of production and performance, has been discontinued) and service contracts are used to define the relationship among the parties. Hospital services can be outsourced and HISMA is formally part of the primary care network (see box III.10).

#### Box III.10

### HEALTH CARE SERVICES MANAGEMENT AND DELIVERY IN THE SAN MIGUELITO REGION OF PANAMA

The general objectives of the new management model were: (i) to integrate the two sources of public funding, the Ministry of Health (MINSA) and the Social Security Fund (CSS); (ii) to separate the functions of funding, procurement and delivery of hospital services; and (iii) to integrate the primary and secondary care systems. Funding and regulatory functions were assigned to the Ministry and the Social Security Fund, and a formal entity (CONSALUD) was created to contract, procure and evaluate services. It was expressly established that services would be provided by an autonomous public agency (namely, the Board of the Saint Michael Archangel Integrated Hospital). The hospital chose to outsource end-user services (hospitalization, out-patient care, and emergency), support services (laboratories and image diagnosis techniques) and general services (security, cleaning, etc.) to private firms. A system of checks and cross-checks was set up for the three levels of care, specifying the obligations and rights applying to each, the records and referral mechanisms to be used and the treatment or referral capability expected of each level. The new management model was also endowed with a legal and contractual framework to govern relations among the parties, as well as instruments to make those relationships work in practice.

**Source:** R. Bitrán, "Reformas recientes en el sector salud en Centroamérica", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

### Regulation and oversight

To the extent that reform processes create incentives for new public-private mixes in health care insurance, funding and delivery, it is essential to continue developing regulatory and oversight mechanisms, as a matter that applies to and cuts across all the forms of organization.

The peculiarities of the health sector exacerbate the market failures that result from information asymmetries in service delivery and insurance. Table III.7 sets out some of these failures and their consequences. While introducing competition is certainly desirable, the fact is that market failures in the health sector mean that genuine, efficiency-promoting competition can occur only under a model with a solid regulatory structure (Arrow, 1962). This applies to the regulation both of the quality and effectiveness of services and of the financial and actuarial aspect of insurance.

The few initiatives that have been undertaken in the region in this regard indicate that, in the absence of proper regulatory structures, encouraging competition in imperfect markets detracts from efficiency and equality. In health care, deregulated competitive markets have led to the practice of cream-skimming and over-consumption of health services, as discussed in relation to Chile and Colombia. This is detrimental to equity and compromises the rational and effective use of resources.

Table III.7  
**MARKET FAILURES, THEIR EFFECTS AND POSSIBLE SOLUTIONS**

| Market failure                           | Effects   | Solutions  | Results  |
|--|---|--|--|
| Adverse selection                        | Risk-aggregation problems.<br>In extreme cases, no insurance available                        | - Education<br>- Subsidies<br>- Mandatory contributions<br>- Universal coverage                | - Not effective<br>- Not effective<br>- Efficient<br>- Efficient |
| Moral hazard                             | Over-consumption of insurance, overuse of medical services                                    | - Regulation and oversight<br>- Co-payments<br>- Deductibles                                   | Moderately efficient   |
| Risk selection                           | Lack of insurance for disabled, sufferers of chronic conditions, the poor and the elderly     | - Regulation and oversight<br>- Community-based risk<br>- Premiums adjusted to individual risk | Moderately efficient, but technically difficult to implement     |
| Monopoly or cartel                       | Excessive benefits, underproduction   | Anti-monopoly regulation   | Not very effective, due to tendency towards concentration        |
| “Free riders” in public insurance sector | Higher financing requirements resulting from service use and incentives to avoid contributing | Regulation and oversight   | Moderately efficient   |

**Source:** W.C. Hsiao, “Abnormal economics in the health sector”, *Health Policy Review*, vol. 32, No. 1/3, June 1995; Daniel Titelman and Andras Uthoff, “El mercado de la salud y las reformas al financiamiento de los sistemas de salud”, *Ensayos sobre el financiamiento de la seguridad social en salud. Los casos de Estados Unidos, Canadá, Argentina, Chile, Colombia*, D. Titelman and A. Uthoff (comps.), Fondo de Cultura Económica, 2000.

The case of Chile in the Latin American and Caribbean region, and others elsewhere, show that the imperfections of the health market prevent the free interplay of supply and demand from improving efficiency. The incentives for risk selection in insurance markets are a key issue affecting efficiency (as well as equity). Insofar as insurers’ profits hinge strongly on risk discrimination, they are unlikely to have incentives to seek improvements in efficiency. In this case, insurers have incentives to avoid high-risk clients, not to improve their resource management. In Chile, the existing public-private mix, combined with a highly deregulated market, has allowed and encouraged risk selection (Titelman, 2000).

As Katz (1995) has argued, the private sector also tends to develop into a provider of high-complexity services. Where this occurs, product differentiation, innovation rents, and the impact of the introduction to the market of new products, processes and ways of organizing medical activity will strongly affect the organization of the health sector and demand special efforts as regards the design of regulatory frameworks.<sup>17</sup>

Strong regulation and capacity to take action are more easily instituted when a single entity is responsible for establishing standards and overseeing all the subsectors (public, private and social security). Regulatory segmentation may have some advantages in terms of specialization, but is much more likely to result in institutions that are weaker and more readily influenced.

## Public health policies

In addition to dealing with the organization of insurance models, health policies must encourage the population as a whole to conform to a pattern of health care consumption that substantially reduces the burden of disease. Such services include highly cost-effective public health activities, such as preventive and curative campaigns at the primary care level (Bitrán, 2005). This section sets out a number of regional recommendations and initiatives concerned with the

<sup>17</sup> The institutional structure, morphology and behaviour of markets, as well as the regulatory framework, can be expected to change over time in a highly complex interactive process that is closely associated with the degree of supply saturation (Katz, 1995).

strengthening of the primary care models. Also, based on the region's often disjointed advances in decentralizing public health care delivery, it offers some recommendations on correcting measures that have worked against equity.<sup>18</sup>

### Expanding primary care

Increasing the coverage of primary care is crucial to the effort to improve access to health care goods and services and thus enhance the population's general state of health. Although expanding the coverage of primary care is always desirable, it is especially important in countries which have limited health-care coverage and a high prevalence of non-communicable diseases.

As part of the reforms aimed at extending health-care coverage to lower-income populations and remote rural areas, efforts have been made to shift primary care centres out of hospitals and into the heart of the beneficiary communities. This has been the strategy implemented by many countries in the region, in some cases by outsourcing to non-public-sector providers and non-governmental organizations (NGOs) and in others by making use of existing private infrastructure or building and running new health posts and centres under the auspices of the health ministry or the social security system, as the case may be. A vital element in these initiatives has been a commitment to improving performance based on new resource allocation instruments and separating financing from service delivery (see boxes III.11 and III.12).

#### Box III.11

#### RECENT INITIATIVES TO REFORM AND EXPAND PRIMARY CARE

In the last few years, a number of the region's countries have devised innovative strategies to expand primary health care, especially in rural areas and among scattered population groups. Some of these strategies are outlined here.

Since the beginning of the 1990s, Bolivia has been steering a health-sector reform directed essentially towards maternal and child health. In 1996, the Ministry of Health created a national insurance system for mothers and children, which was expanded in 1999 into what was known as Basic Health Insurance (SBS). In view of Bolivia's eminently pre-transitional epidemiological status and the limited resources the country is able to devote to health care, the scheme consists basically of a package of 75 services, focusing on the main causes of maternal and child deaths and on communicable diseases. Users are not required to pay into the system. It is funded by the municipalities, using resources earmarked from the tax-sharing proceeds they receive from the national treasury and other compensation mechanisms. In order to guarantee the services specified in the SBS scheme, Bolivia has successfully engaged other service providers, such as NGOs, churches, private providers and the country's various health funds, which deliver care for affiliates in their own establishments. Based on the success of this programme, a Universal Mothers' and Children's Insurance (SUMI) scheme was designed with the explicit intention of removing economic barriers to health care access for mothers and children under five years of age.

In Nicaragua, the Ministry of Health is the main provider of preventive and primary health care. Generally speaking, its programmes afford priority to care that can reduce morbidity and mortality among mothers and children. They are operated by a network of health centres and medical posts located across the country, and receive support from primary health care programmes funded by foreign cooperation agencies (Bitrán, 2005; Rodríguez, 2005d). The programmes operate both through establishments and posts that cover a particular geographical area and within the beneficiary communities, through Local Integrated Health Care Systems (SILAISs), which provide information, promote healthy habits and deliver care. The work carried out in these local systems has built up the local capacity of the Ministry of Health and of midwives, volunteers and other members of the community involved in health care. They have also helped to empower the population —especially women— as regards decision-making in matters of family health.

<sup>18</sup> Strengthening and modernizing public hospitals is an issue closely associated with the agenda set forth here. A proper evaluation of the needs and challenges in this area would require a level of detail beyond the scope of this chapter. Among other matters, it would have to examine the different types of microeconomic organization seen in the region, degrees of institutional and financial autonomy, the level of integration of health care networks and articulation with the private sector.

## Box III.11 (concluded)

El Salvador relies mainly on outsourcing to NGOs as a means to increase the coverage of primary care services, in the framework of its Essential Health and Nutrition Services Programme (SESYN). The strategy of the programme is based on targeted public subsidies in combination with an integrated mother-and-child health care package, which also includes a number of preventive and curative procedures. Four NGOs were selected, each of which receives US\$ 20 per person per year. This is used to fund a care network composed of health promoters and itinerant health teams (EIS) which have a mid-level treatment capability and the power to refer patients to treatment units overseen by the Ministry of Health. The Ministry also contributes US\$ 11 per person annually for equipment, medicines and supplies.

Guatemala's recent reform is based on three service models, with mechanisms similar to those employed in Nicaragua and El Salvador. The first consists of the State's outsourcing basic health care services to NGOs. The second outsources the Ministry of Health's financial administration and provision medical services, also to NGOs. The third is the traditional model developed by the Ministry, aimed at strengthening medical care at local health posts (Bitrán, 2005). The main objective of the reform is to broaden a basic care package and improve the quality of services, particularly for the rural population. Among other services, the package includes maternal and child care and better coverage of communicable diseases and environmental health. The contractual arrangements with NGOs were introduced through the Integrated Health Care System (SIAS) and include a number of different financial mechanisms and levels of service.

Reform in Honduras has also focused on expanding coverage to rural areas. The Programme for Institutional Reorganization and Expansion of Basic Health-Sector Services (PRIESS) has been in place since 1998. It aims to provide a basic package of health services to extremely poor rural populations, employing itinerant teams hired on a capitation basis from NGOs or other private providers. In three years of functioning, it had served 1,142 rural communities comprising 60,000 families and 289,000 individuals in the country's 95 poorest municipalities, based on a capitation payment of approximately US\$ 18 per year. The new ProReforma management models consist of more recent initiatives, based on special civil society organizations. The impact of these is limited, since they are still at a pilot phase, but they have potential for expansion. Prominent among these initiatives is La Caridad health clinic in El Guante. La Caridad has a contract with the Secretariat of Health to provide a package of care and preventive services to the covered population for an annual payment of US\$ 16 per capita, which is supplemented by an additional prepayment of approximately US\$ 1.50 per person, distributed according to families' ability to pay.

Lastly, in Costa Rica, reorganizing primary care has been one of the core components of health-sector reform. The reorganization is based on the transfer of responsibility for primary care from the Ministry of Health to the Costa Rican Social Security Fund, and on creating basic health care teams whose aim is to enhance the impact of primary care on the population's health at as little cost as possible. These teams provide primary care, while hospital establishments are responsible for emergency services. Each team comprises a general physician, a nurse's aide and a primary health care technician, and is advised by a support team that serves all the basic health care teams in its health area. The primary care services provided include health promotion, preventive and curative care and non-complex rehabilitation. The rapid expansion of these teams has made primary care virtually universal in Costa Rica.

**Source:** Adolfo Rodríguez, "Reforma de salud en Costa Rica", working document, Santiago, Chile, 2005, unpublished; "Reformas de salud en Nicaragua", work document, Santiago, Chile, 2005, unpublished; "Reformas de salud y nuevos modelos de atención primaria en América Central", work document, Santiago, Chile, 2005, unpublished; "Reformas de salud en Honduras", working document, Santiago, Chile, 2005, unpublished; and R. Bitrán, "Reformas recientes en el sector salud en Centroamérica", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC) 2005, unpublished.

Box III.12  
**EXPANSION OF PRIMARY CARE WITH AN URBAN FOCUS  
 IN THE BOLIVARIAN REPUBLIC OF VENEZUELA**

The Government of the Bolivarian Republic of Venezuela has rolled out a massive health initiative whose main target is the urban population. The *Barrio Adentro* (“Into the Neighbourhood”) programme was piloted in April 2003 in the municipalities of Libertador and Sucre, in the metropolitan district of Caracas. Later that year, it was decided to expand the scheme to the rest of the country on a massive scale. This expansion was to take place in several phases and engage a number of public agencies. The programme’s guiding principle is to consolidate primary care as the priority for national health policy, in a framework built around the tenets of universality, equality, free care, participatory management and social co-responsibility, in order to provide access to health care for excluded population groups.

*Barrio Adentro* is implemented in the framework of the country’s technical cooperation agreement with Cuba. It aims to increase the treatment and referral capability of the out-patient network of primary care, by establishing, consolidating and expanding local health practices (*consultorios populares*), which are each staffed by a physician, a nurse and a social outreach worker, serving around 250 families in a particular geographical area. These *consultorios* form the core of the integrated health management system. They represent patients’ first point of contact with the health care system and, except in medical emergencies, are an obligatory stage for referral to secondary or tertiary care facilities, as in the Cuban system and the United Kingdom’s National Health Service. The network of *consultorios* is articulated with a network of local pharmacies and it is anticipated that they will coordinate with secondary and tertiary institutions as the Venezuelan health care system expands. In addition to dealing with illness, the staff are responsible for promoting preventive care and encouraging healthy habits in the population at large. Community engagement is organized around a number of mechanisms, including health committees.

Assessments conducted by the National Institute of Statistics indicate a high level of user satisfaction with the services provided. The number of visits to health centres is increasing and access to medicine and preventive care is expanding. In November 2005, *Barrio Adentro* had over 28,000 professional staff, each conducting more than 17 medical consultations per day, giving a cumulative total of over 150 million health consultations. The programme also provides optometry and dentistry services.

**Source:** Ministry of Health and Social Development, Bolivarian Republic of Venezuela.

The new primary care models that have been developed in the region have yielded not only substantial results but also valuable lessons for the redesign of health policies. One such lesson is the importance of strengthening the primary care system across its components of care, prevention and promotion, although this last aspect has received less attention than the other two. The fruit of these efforts is seen in the disappearance of such diseases as smallpox, measles and polio, and lower incidences of tuberculosis, dengue and malaria, among other conditions. The depth, scope and continuity of these efforts, as well as their results, have been a direct function of the volume of financial resources allocated and the degree of institutional development in each country. Given the scarcity of resources, the strategy of targeting the most serious problems of the vulnerable population has been successful. If it is to remain viable in the long term, however, this strategy needs to be closely coordinated with other policies in the area of health and those concerning infrastructure, education, nutrition and housing, which also affect health conditions.

This being so, primary care initiatives cannot be approached as isolated programmes: instead, the entire network needs to be redesigned and the different levels of care have to be very precisely articulated. Costa Rica has piloted the most ambitious initiative of this kind, increasing the treatment and referral capability of out-patient facilities and establishing relatively clear gateways into the system for patients, with procedures for referral and cross-referral. Nicaragua also has taken steps that have placed it well along the road in this direction, especially as regards its recent hospital modernization initiatives.

Not enough empirical evidence is available to assess the benefits and drawbacks of outsourcing public health care services to NGOs, as opposed to direct public service provision. Nonetheless, it seems reasonable to suppose that, given the financial obstacles to expanding public service provision, State initiatives to fund the provision of basic health care services through private institutions can represent a rational use of the existing human and physical resources and contribute

to more effective allocation of social resources not only at the primary care level, but also at the secondary and tertiary levels. For this to occur, however, a strong regulation and oversight structure must be in place to avoid the risks associated with the information flaws typical of health care markets (Bitrán, 2005). In this regard, it is essential to improve oversight and technical quality control of the services provided by NGOs, and to review the types of performance agreement being used by health authorities and NGOs.

### Coordination and compensation in decentralized systems

Since the 1980s, and especially during the 1990s, the decentralization of public health service delivery has come to play a central role in Latin American and Caribbean public policy. In the last few years, many of the region's governments have embarked on processes that include policies to reform faculties and competencies. Generally speaking, these processes are identified by the common denominator of "decentralization" although, strictly speaking, they are distinguished by a number of different and specific characteristics.<sup>19</sup> Be that as it may, they result in subnational governments gaining a larger role in managing public affairs.

This trend is evident in some of the region's federal countries, such as in Argentina, Brazil and Mexico, which have transferred some functions from national government to lower levels; in countries with unitary systems of government which have delegated substantial competencies to local government, as in Colombia and Chile; and in traditionally unitary and highly centralized countries that are creating new intermediate levels of government, to which they delegate either the formulation and implementation of important public policies or merely the management thereof, such as Bolivia, Peru and Paraguay.

Measures to decentralize spending tend to be associated with efficiency-seeking; hence, efforts to improve the resolution of local problems are combined with a lower fiscal cost. Arguments for decentralization propose that the closer the service is delivered to the beneficiaries, the better resource allocation will be, since spending decisions will be guided by local preferences and citizens will have a more direct and effective control over them. This certainly assumes that the costs and benefits of services are limited to the geographical area defined by the policy. It also requires the local community to have institutional mechanisms by which to express preferences and exercise the right to oversee the allocation of public funds. Placed in the context of the health sector, these arguments raise two particular problems. One is that it is unrealistic to suppose that the provision of services in one jurisdiction will not affect the well-being of neighbouring populations (through externalities). Another is that there are strong grounds to reject the proposal that each jurisdiction should be responsible for the health care of its inhabitants in a totally independent manner, since major disparities can occur between needs and capacity. There is a need for clearly delineated policies on regional compensation, instrumented in a decisive manner.

These problems have not always been addressed explicitly, however. The corresponding processes are set into a context of fiscal constraints in which macroeconomic equilibria usually take precedence, and notable territorial inequalities are evident in the distribution of resources for health service provision. Table III.8 shows the principal landmarks in the decentralization process in a group of countries studied in the 1990s in the framework of the ECLAC regional project on public funding and provision of social services.<sup>20</sup>

<sup>19</sup> "Political decentralization" and "devolution" refer to processes in which local governments are given not only the responsibility of implementing decisions, but the power to make them. "Administrative decentralization", on the other hand, refers to a process in which the central government retains the power to formulate policies, but execution is the responsibility of the subnational level. "Administrative deconcentration" refers to spreading responsibilities out within the central government, which is limited to the distribution of responsibilities among central government's local offices.

<sup>20</sup> Gropello and Cominetti (1998) present summaries of the case studies and comparative analyses.

Table III.8  
**LATIN AMERICA (SELECTED COUNTRIES): HISTORICAL EVOLUTION OF  
 HEALTH CARE DECENTRALIZATION**

| Country   | Decentralization landmarks  |
|-----------|---|
| Argentina | <p>Until 1945: Anarchic decentralized model</p> <p>1955-1978: Decentralization of a non-articulated system</p> <p>Since 1978: Decentralization steered by the financial relationships between the national government and the provinces</p>   |
| Bolivia   | <p>1994: Delegation of responsibilities at the municipal level</p> <p>1995: Delegation of responsibilities at the departmental level</p> <p>1996: New health care model</p>   |
| Brazil    | <p>1978-1983: First integration initiatives (AIS). Social movements demand institutional changes in health policy</p> <p>1984-1991: Creation of a unified and decentralized health system (Single Health System), with the decisive step coming with democratization. In 1988, the Single Health System is enshrined in the Constitution (but with ambiguous assignment of competencies), and in 1990 a regulatory structure is put in place</p> <p>1992-1996: Transfer to municipal level gathers momentum</p>   |
| Chile     | <p>1981-1982: Experimental transfer of the executory function (primary care and infrastructure) to the municipal level. Suspended during the crisis, and reinstated in 1987</p>   |
| Colombia  | <p>1968: Revenue-sharing system established as part of the deconcentration of fiscal resources</p> <p>1986: Decentralization of investment in the infrastructure of primary care institutions to the municipal level</p> <p>1990: Decentralization of service delivery. The process is deepened by decentralizing some health service management and oversight functions to the municipalities, which thus become responsible for delivery of care and operational matters at the first level of health care, while the departments are made responsible for the secondary and tertiary levels</p> <p>Constitution of 1991: Health services are organized on a decentralized basis by levels of care with community participation, and social security becomes mandatory</p> <p>1993: Regulatory mechanisms are established to govern the Constitution's provisions on subnational management and insurance. The decentralized social security system becomes operational for health care</p> |
| Mexico    | <p>1983-1987: First stage of health-sector decentralization, following a coordination model rather than decentralization, since authority is not transferred</p> <p>1988-1994: Consolidation of the local health systems model (SILOS). Efforts are made to strengthen the technical and administrative capacity of the decentralized jurisdictions, leading to administrative deconcentration (hiring of middle management was delegated downwards followed, in 1994, by staff payment)</p> <p>1996: New decentralization model. Resources and competencies transferred to states</p>  |
| Nicaragua | <p>1982: Regionalization of the Ministry of Health. Primary and secondary care unified under regional authorities reporting to the Ministry, within the framework of a unified health care system</p> <p>1987-1989: Budgetary decentralization</p> <p>1990: Budgetary recentralization</p> <p>1992: Creation of local integral health care systems (SILAISs)</p>  |

**Source:** E. Di Gropello and R. Cominetti (comps.), *La descentralización de la educación y la salud. Un análisis comparativo de la experiencia latinoamericana* (LC/L.1132/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 1998.

A review of health care decentralization initiatives in Latin America shows that they follow a large variety of patterns in terms of the speed, sequencing and nature of responsibility reallocation. There are common elements, nonetheless. In most cases, decentralization in the health sector has been steered by the central government and motivated by a variety of considerations that are not always directly associated with the health sector—notably, economic and political factors.

In addition, the main constraint on the autonomy of subnational governments is their excessive dependence on central government resources. This is a feature shared by all the countries, regardless of the extent to which governmental social spending has been decentralized. Given the gradual nature of the reforms and the lack of systematic data, it is very difficult to evaluate the efficiency and equity of this process.

To sum up, although in some cases decentralization was construed as a means to promote greater civil society participation and support the region's recent democratic processes, insofar as decentralized delivery of health care has made services more dependent on local financial and human resources, the reforms have undoubtedly risked widening quality gaps in situations where existing regional imbalances are already very pronounced. This being so, it is very important for reform policies to include the design and implementation of regional articulation and compensation mechanisms, in order to foster equity and intraregional solidarity in the reform process.<sup>21</sup>

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<sup>21</sup> Brazil has pioneered an interesting initiative as regards coordination and compensation in decentralized systems, which includes health councils, management agreements and a variety of commissions.



## Chapter IV

# Pension systems

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## Introduction

Although the countries of the region have taken many steps to reform their pension systems, they have so far been unable to provide adequate protection to large sectors of the population, and expansion of coverage remains the key pending task.

Countries that have maintained pay-as-you-go (PAYG) systems without introducing appropriate parametric reforms find themselves fiscally constrained when paying pensions to current retirees and have been unable to adequately absorb population groups that have no saving capacity of their own. In addition, while the structural reforms made in pension systems in several of the region's countries over the past 25 years have eased long-term financial pressure on PAYG systems, they have also tended to undermine the solidarity inherent in traditional systems and have failed to improve contributions-based pension coverage. Furthermore, in some cases the transition from PAYG schemes to a fully funded system have generated considerable short-term fiscal pressure.

In terms of social insurance, the entitlement and enforceability of rights discussed in chapter I are reflected in the need to guarantee a decent and secure old age, which in turn requires improved coverage, solidarity and financial viability. These objectives are complementary and should be present in all reform processes.

While the institutional mechanisms used to achieve these objectives depend on the current characteristics of the countries' pension systems, a number of challenges have been identified that are inescapable in most cases. First, non-contributory pension components need to be strengthened to cover sectors that have little or no capacity to save for old age. The need to unify contributory systems to promote equity and efficiency should be complemented by a reform of criteria relating to financing and the benefit structure, to guarantee their financial sustainability. Finally, the problems faced by large segments of the population in generating savings to finance decent pensions mean that both contributory and non-contributory solidarity-based funding mechanisms need to be improved and deepened.

The following paragraphs evaluate the current situation of pension systems in the region, review the key results of recent reforms, and propose elements for a reform agenda.

## Stylized facts

The current reality and future prospects of the region's pension systems depend on a number of factors, such as the rapid process of demographic ageing; lack of (or inadequate) coverage provided by contributory pension schemes; and problems of segmentation and insolvency from which some of the traditional schemes in the region have suffered. These elements point to the need, first of all, to find ways to substantially expand the pension coverage of national pension systems; and second, to improve or reform their contributory components and move towards integrated, equitable, solidarity-based models that are financially sustainable.

### Ageing

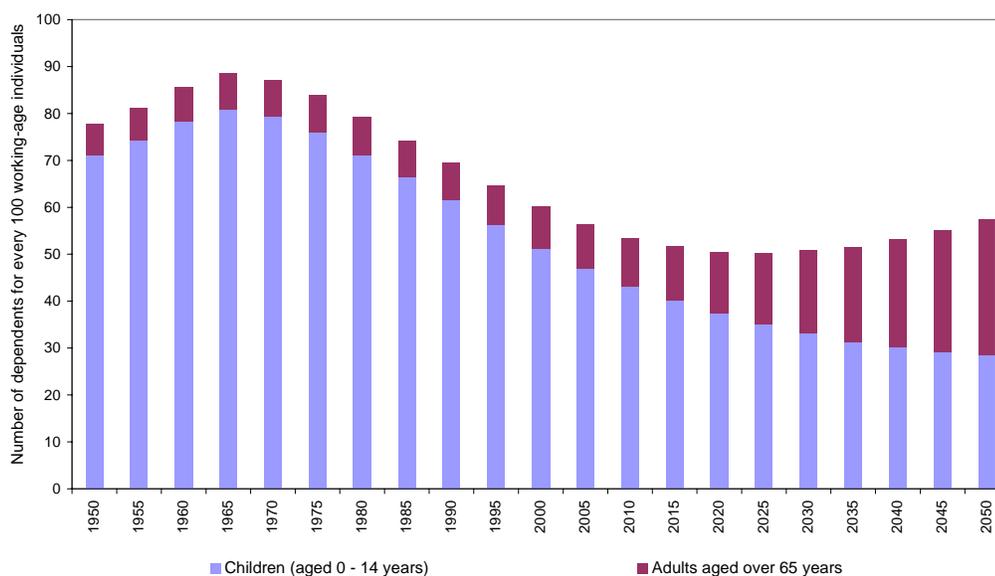
The region is embarking upon a rapid phase of population ageing, which highlights the importance of satisfying the consumption and health-care needs of a growing number of older adults. This phenomenon will put considerable pressure on the financing of both contributory PAYG and non-contributory pension systems.

This regional ageing process, one of the most rapid in the world, can be characterized by two phenomena that have been features of the last few decades: low fertility rates and longer life expectancy. Although the region is expected to register a short-run dip in the total demographic dependency ratio (the number of children and older adults for every person of working age), the ageing process will be dominating fertility as early as 2025, and the region's overall dependency ratio will rise steadily (see figure IV.1).

The fact that population trends in the region are highly varied reflects the relative importance of the demographic factor in the different countries (see figure IV.2).

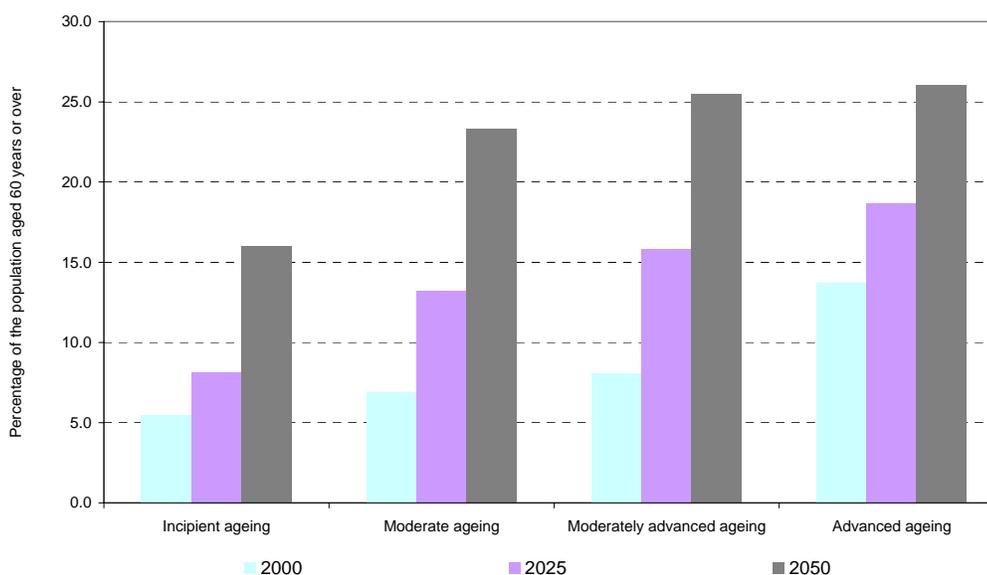
An initial group of countries in which ageing is incipient includes Bolivia, Guatemala, Haiti, Honduras, Nicaragua and Paraguay, where the proportion of the population aged 60 or older varies between 5% and 7% (in 2000), and is set to climb to 15%-18% by 2050. The process could accelerate if the downward trend in the fertility rate were to become entrenched or grow steeper. The second set of countries, characterized as experiencing "moderate ageing", have between 6% and 8% of their populations aged 60 or more, rising to over 20% by around 2050. This group includes Belize, the Bolivarian Republic of Venezuela, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guyana, Mexico and Peru. These countries experienced profound changes in fertility between approximately 1965 and 1990.

Figure IV.1  
**LATIN AMERICA AND THE CARIBBEAN: DEMOGRAPHIC DEPENDENCY RATIO**  
*(Number of dependents for every 100 working-age individuals)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC)/Latin American and Caribbean Demographic Centre (CELADE) - Population Division of ECLAC, "Latin America: Population by calendar years and single ages, 1995-2005", *Demographic Bulletin*, No. 71 (LC/G.2197-P), Santiago, Chile, January 2003; and United Nations, *World Population Prospects. The 2000 Revision* (ESA/P/WP.165), vol. 1, New York.

Figure IV.2  
**LATIN AMERICAN AND CARIBBEAN COUNTRIES BY PHASE OF THE AGEING PROCESS, 2000, 2025 AND 2050**  
*(Percentage of the population aged 60 years or over)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC)/Latin American and Caribbean Demographic Centre (CELADE) - Population Division of ECLAC, "Latin America: Population by calendar years and single ages, 1995-2005", *Demographic Bulletin*, No. 71 (LC/G.2197-P), Santiago, Chile, January 2003; and United Nations, *World Population Prospects. The 2000 Revision* (ESA/P/WP.165), vol. 1, New York.

They are followed by countries displaying “moderately advanced ageing” in which the proportion of older people is currently between 8% and 10%, but is set to grow rapidly to 25%-30%. This group includes Bahamas, Brazil, Chile, Jamaica, Suriname, and Trinidad and Tobago. Lastly, the “advanced ageing” group consists of countries such as Argentina and Uruguay, the pioneers of the ageing process in Latin America, along with Cuba and several Caribbean countries (Barbados, Guadeloupe, Martinique, Netherlands Antilles and Puerto Rico).

Sooner or later these significant demographic changes will exert growing financial pressure on pension systems throughout the region, increasingly forcing countries that use PAYG models to make major changes to system parameters and to take over the funding of non-contributory pensions for growing numbers of older adults living in poverty.<sup>1</sup>

### Low pension coverage

The precarious structure of labour markets in the region tends to have a negative impact on contributory social protection through low rates of contribution and a close relationship between an individual’s type of labour-market participation and his/her contribution capacity. As the pensions paid by contributory systems depend on the individual’s capacity to make regular contributions throughout the life cycle, a modest contributory record results in limited or very low-quality pension coverage. It is therefore essential to extend coverage through non-contributory schemes.

A clear measure of the capacity of pension systems to provide means of subsistence to older adults is the proportion of this population group that receives income from retirement or other pensions. Figure IV.3 displays this indicator for 18 of the region’s countries and for different age groups. Despite significant regional variations, a simple average shows that just four out of every 10 people over 70 directly receive some type of income through retirement or other pensions.<sup>2</sup>

Brazil and Bolivia stand out as countries that display a high level of old-age protection, despite intermediate or low contributory coverage. As noted below, this is the direct result of the high level of coverage achieved by the Brazilian rural pension programme and the Bolivian universal pension programme.

Ultimately, very low contributory coverage forces families to act as one of the main sources of protection for older people, to whom they provide housing and food, among other services (see box IV.1). Although families make a valuable contribution, this solution should be the result of personal choice rather than need.

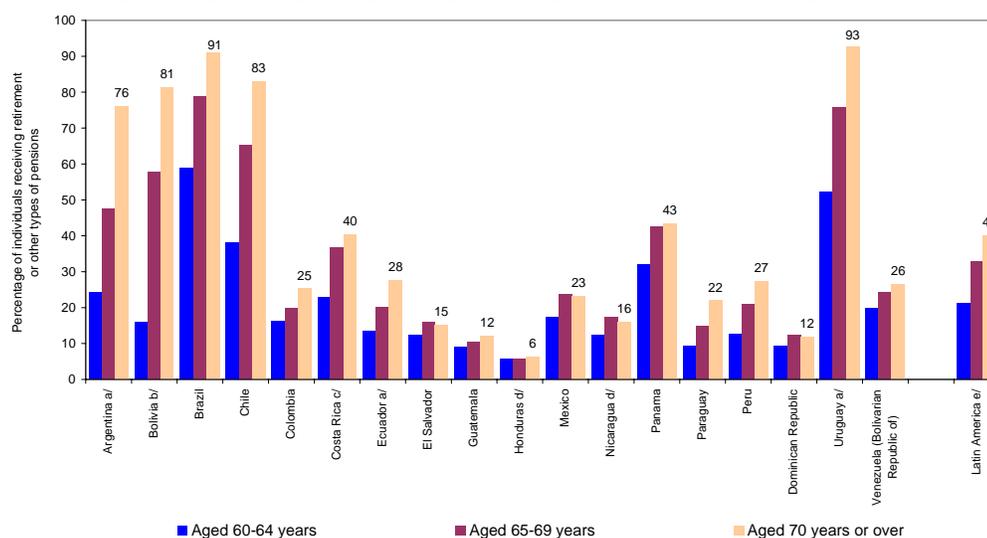
Apart from finding ways to boost pension coverage through contributory channels, the foregoing analysis shows that it is essential to develop or consolidate non-contributory pension models to encompass population groups that have historically been excluded from formal mechanisms of saving for old age.

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<sup>1</sup> Furthermore, increased longevity entails greater pension demands that will require adjustments to be made in terms of replacement rates, retirement age, or rates of contribution to contributory systems.

<sup>2</sup> Some of these people are partially covered by the pensions of their spouses, and, in the event of the latter’s death, by survivor benefits.

Figure IV.3

**LATIN AMERICA: RECEIPT OF INCOMES THROUGH RETIREMENT OR OTHER PENSIONS**

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

- <sup>a</sup> Corresponds to surveys undertaken in urban zones.
- <sup>b</sup> Includes Boliviada and Bonosol.
- <sup>c</sup> Only includes pension income.
- <sup>d</sup> Retirement or other pensions received by a family member.
- <sup>e</sup> Simple average of the countries.

**Box IV.1****OLDER ADULTS AND THE FAMILY**

Conditions for economic security in old age are inadequate and unequal in Latin America and the Caribbean. Shortcomings in social security systems make family transfers important, both within the household and outside it. These take various forms, ranging from direct monetary assistance to personal care for a sick or partially disabled relative. The most common form of family solidarity is co-residency, which provides shelter, food, services and company. The following statistics indicate the frequency of this modality in the region: (i) over 70% of older adults live in multigenerational households; (ii) when the older adult lives in a household headed by a person under 60 years of age, the latter is usually their son or daughter; (iii) only 10% of older adults live alone (25% in developed countries), and even those who are unmarried mostly do not live in single person households; and (iv) indices of institutional residency are low. This pattern of multigenerational co-residency means that investment in older people has multiplier effects on families.

The available data appear to show that older adults also help their families. As they are mostly heads of household and owners of the homes in which they live, co-residency implies economies for younger generations. Previous studies have also shown that older people are net contributors to the household income. According to ECLAC (2000c), in roughly one third of urban households in which older adults live with individuals of other age groups (excluding spouses), they contribute over half of the household's income. This proportion ranges from 17% in the Bolivarian Republic of Venezuela and 19% in Mexico, to 39% in Chile and 46% in Bolivia. The figures are even higher in rural areas, varying from 28% in Panama to 68% in Argentina. Basso (2005) notes that the extension of social security benefits in Brazil has not only favoured older adults but has also helped to improve the situation of their families.

Involving the family in the social protection of older adults requires: (i) adhering to the principle that the chief responsibility rests with formal social-security systems; (ii) guaranteeing the principle of preference, in which co-residency is an option but not an obligation; (iii) supporting the family to enable it to look after its older members, and (iv) placing a higher value on family-based protection, since this involves direct costs for the family and generates several economies for society.

**Source:** Eduardo Basso, "Benefícios contributivos e não-contributivos: impactos da previdência social sobre a pobreza", document presented at the Meeting of Governments and Experts on Ageing in South American Countries, Buenos Aires, 14-16 November 2005; Economic Commission for Latin America and the Caribbean (ECLAC)/Latin American and Caribbean Demographic Centre (CELADE) – Population Division of ECLAC, *Population, ageing and development* (LC/G.2235(SES.30/16)), Santiago, Chile, June 2004; ECLAC, *Social Panorama of Latin America 1999-2000* (LC/G.2068-P), Santiago, Chile, 2000. United Nations publication, Sales No. E.00.II.G.18.

## Problems of segmentation and financial sustainability

Contributory pension systems in the Americas, which have traditionally been organized in the form of PAYG schemes, have been called into question for a number of reasons. These include the difficulty of coping with major demographic changes; the fact that reserve funds are vulnerable to “political uses”; the high degree of (inequitable) segmentation of those systems; and the relationship between contributions paid into the system and benefits received (generally under defined-benefit schemes), which allow for considerable cross-subsidization that is usually not very transparent, not always solidarity-based, and has the potential to impair systemic solvency.

In view of these shortcomings in traditional PAYG systems and their political consequences (see table IV.1), several of the region’s countries made structural reforms to their pension systems in the 1990s, totally or partially replacing their various PAYG systems with fully funded models.

Table IV.1  
**FREQUENT CRITICISMS OF PAYG AND DEFINED-BENEFIT SCHEMES**

| Problem  | Characteristic  | Policy recommendations  |
|--|---|---|
| Low-portability segmented systems <sup>a</sup>         | Multiple private and public systems and high-cost special regimes   | Standardize, unify and promote portability  |
| Evasion or avoidance in social security or tax systems | Limited capacity to finance pensions through contributions obtained from wages or general taxation  | Change the conceptualization of social security contributions from a tax to saving, by using individual accounts (either financial or notional) |
| Complex benefit rules                                  | Non-transparent and not necessarily progressive redistribution, which provides few incentives for formalization   | Separate the contributory from the non-contributory component, and make solidarity more transparent and more progressive                        |
| Low return on investment of reserve funds              | Used in social policies, little protection and supervision of fund profitability  | Need for clear rules on investment and supervision of pension funds   |
| Adverse demographic and labour-market trends           | Informality of employment and population ageing   | Need to expand the contributory base and extend non-contributory coverage   |
| Excessively generous defined-benefit rules             | Very weak relation to contributions paid leads to under-contributing in youth and over-contributing in the final years, thereby causing a financial imbalance | Develop a closer relation between contributions and benefits (defined contributions)  |
| High administrative costs                              | Caused by the multiplicity of systems, duplication of functions and administrative inefficiency   | Need to reform administrative management or introduce competition for fund management   |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of ECLAC “Pension systems in Latin America: diagnosis and reform alternatives. Case studies in Latin America and the Caribbean; conclusions and recommendations”, *Financiamiento del desarrollo series*, No. 9 (LC/L.656), Santiago, Chile, 1991; Andras Uthoff, “Reforma a los sistemas de pensiones en América Latina y el Caribe”, *Financiamiento del desarrollo series*, No. 29 (LC/L.879), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 1995; Daniel Titelman and Andras Uthoff, “The role of insurance in social protection in Latin America”, *International Social Security Review*, vol. 58, No. 2-3, 2005.

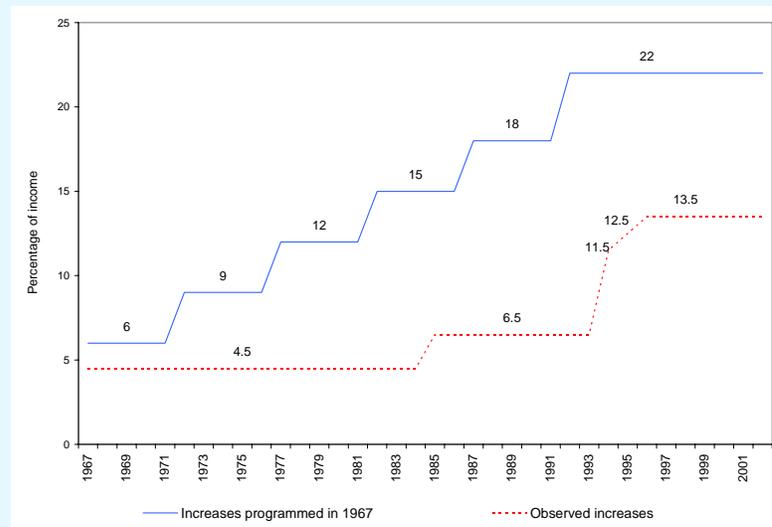
<sup>a</sup> The problem of high segmentation has been most common in the first of the region’s countries to establish social security programmes or in those whose State structure is substantially decentralized. In Colombia at one point there were 1,000 social security programmes coexisting in the public sector; while, in the year prior to the reform, Chile had 90 special pension funds for workers in different sectors. In Mexico, special systems still exist for private-sector workers (12 million), federal employees (2.5 million), State employees (900,000) and para-State employees (247,000), in addition to special regimes covering public universities, development banks and municipalities. The average pension paid by the para-State sector in 1997 was roughly twice that received by other public-sector employees, and over six times the average benefit received by workers in the private sector (Aguirre, 2005).

The combination of generous and inadequately funded special regimes, compounded by a failure to make the necessary parametric adjustments to maintain the financial balance of a public PAYG system, can generate excessive increases in pension liabilities (see box IV.2).

### Box IV.2 THE COLOMBIAN PENSION SYSTEM

The Colombian pension system has undergone substantial parametric and structural reforms over the last 15 years as various factors have resulted in a situation where monthly pension payments currently represent roughly 5% of GDP, with the net present value of pension liabilities estimated at between 170% and 190% of GDP. Despite this, only a small proportion of the population (roughly 24% of the over-65s in 2002) receive pensions from this system in old age. The causal factors of this large projected fiscal deficit include the absence of the parametric adjustments that were programmed when the PAYG regime and the graduated average premium were created in 1967 (see figure below).

#### COLOMBIA: PROJECTED AND OBSERVED PENSION CONTRIBUTION RATES



Other factors that have helped to create these sizeable pension liabilities are generous special benefit regimes (public funds at regional, sector and firm level, the teachers fund and the armed forces fund); special benefits (such as the “14th month”) granted to most pensioners without a matching increase in contribution rates; a relatively early retirement age (55 in the case of women and 60 for men) in relation to the population’s increasing life expectancy; and a generous minimum pension guaranteed to pensioners in the different systems, equivalent to 100% of the minimum legal wage, representing roughly 23.7% of GDP in 2003 in net present-value terms. Lastly, implicit in these liabilities is the cost of moving from a PAYG regime to one in which this coexists with a system of individual funded accounts.

**Source:** M. Agudelo, “El Sistema Pensional Colombiano. ¿Cuál es la reforma pensional que necesita Colombia?”, *Debates de coyuntura económica*, No. 57, Foundation for Higher Education and Development (Fedesarrollo), October 2004; S. Clavijo, “Pensiones: yo voy a hacer un inventario”, *Informe semanal*, No. 785, National Association of Financial Institutions, June 2005; C. Pérez, V. Navas and M. Jordán, “Sistema Pensional Colombiano”, document presented at the XVII regional seminar on fiscal policy, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), October 2004; and C. Marulanda, V. Navas and M. Jordán, *Sistema Pensional Colombiano*, Bogotá, D.C., Consejo Superior de Política Fiscal, Ministry of Finance and Public Credit.

### Non-contributory pensions in Latin America and the Caribbean

Historically the countries of Latin America and the Caribbean (with notable exceptions) have made a relatively minor effort to prevent poverty in old age. The solidarity models of the contributory systems prevailing in some countries cover people with relatively stable job histories. The few non-contributory programmes that exist in the region, while fundamental in the fight against poverty, provide limited and uncertain welfare protection that does not reflect a clear principle of universal social protection.

The Brazilian rural pension system is one of the main examples in the region of the extension of pension coverage through non-contributory mechanisms. While linked to a minimum period of

activity (12 years) in the agriculture sector and partly financed out of taxes levied on the sale of agricultural products (which has led some analysts to dub the programme semi-contributory), this initiative in practice represents a form of geographically targeted non-contributory pension that has made it possible to greatly reduce poverty in traditionally rural areas such as the north-east of the country.<sup>3</sup>

As will be seen below, one of the main recent innovations in the region is the Bonosol programme in Bolivia, which since 1997 has been paying a universal pension to all citizens over 65 years of age, irrespective of their contribution record or socioeconomic level. This programme has made it possible to significantly extend pension coverage in a country whose contributory coverage is relatively low, although benefits have been decreasing through time.<sup>4</sup>

In contrast, most social protection systems in developed countries include non-contributory components that deliver basic benefits to individuals who have been unable to accumulate the minimum contributions needed to gain access to contributory pensions, and in general, to those who have reached old age and are unable to finance their basic expenses. Box IV.3 illustrates how the models applied in the United States and Canada have incorporated significant non-contributory components into their social protection networks, which have succeeded in substantially reducing poverty in old age.

#### Box IV.3

### PREVENTION OF OLD AGE POVERTY IN THE SOCIAL SECURITY SYSTEMS OF CANADA AND THE UNITED STATES

Canada's Retirement Income System (RIS) is viewed as a successful example of the eradication of poverty in old age. The system provides most older adults from lower- and middle-income strata with the resources needed to preserve their living standards during retirement. High-income families, however, usually tend to complement public pensions with different forms of voluntary saving.

The system has three basic components: (i) one non-contributory, explicitly aimed at preventing poverty in old age, and consisting of at least three programmes: security in old age, guaranteed income supplement, and husband and wife benefit; (ii) A PAYG component, the Canadian pensions plan, and (iii) a voluntary component in the form of saving programmes sponsored by employers or individual savings accounts, which enjoy favourable tax treatment and are intended to complement the other two components.

This protection network managed to reduce poverty among older adults from 28.4% in 1973 to 5.4% in 1997, making Canada one of the countries with least relative poverty in the world.

The United States currently has three federal programmes that support older adults: an insurance covering older adults, survivors and the disabled, better known as Social Security; a supplementary income programme; and Medicare, a medical insurance model for older adults. The social security programme, which is mandatory and virtually universal, provides incomes to older adults financed out of payroll taxes levied on the economically active. The Supplemental Security Income programme also serves as a non-contributory support network guaranteeing a minimum income to older adults and the disabled, if their pension benefits are very low or they do not qualify for social security.

A combination of social security (which is designed to be highly progressive in its replacement rate structure) and the supplemental income has made it possible to achieve a substantial reduction in poverty among older adults over the last few decades (from 15% in 1976 to 10.4% in 2002). Nonetheless, comparisons with other developed countries reflect unfavourably on the United States, where the incidence of relative poverty among older adults is higher than in Europe, Australia or Canada.

**Source:** Helvia Velloso, "Social security in the United States: overview and outlook", Washington, D.C., ECLAC office in Washington, D.C., 2005, unpublished; H. Velloso and François Vézina, "The Canadian Retirement Income System", Washington, D.C., ECLAC office in Washington, D.C., 2005, unpublished.

<sup>3</sup> Nonetheless, it is estimated that roughly 3 million rural workers are still excluded from the rural benefit because they are seasonal workers with no fixed job or address. As such they have no way of documenting their activity or of contributing to social security.

<sup>4</sup> The United Progressive Party of Antigua and Barbuda won the presidential election in late 2003 on a universal pensions platform. So far, however, this programme has not been applied (Willmore, 2005). At the subnational level, in 2001 the Mexico City government introduced a monthly food and medicine voucher for all residents over 70 years of age. Inspired by the political success of this initiative, several other local government entities in Mexico are considering similar initiatives (Azuara, 2005).

## Recent reforms to pension systems in Latin America and the Caribbean

The main pension reforms undertaken in the region have taken the form of periodic changes in the key design elements of PAYG models (parametric reforms) or structural reforms that introduce individual full-funding components (see table IV.2). This section describes the main characteristics of these reforms and analyses their effects in terms of coverage, solidarity, sustainability and efficiency.<sup>5</sup>

Table IV.2  
**LATIN AMERICA AND THE CARIBBEAN: PENSION REFORM MODELS  
AND CHARACTERISTICS**

| Reform model, country and starting date  | Financial regime                  | Benefits calculation | Management |
|--|-----------------------------------|----------------------|------------|
| <b>Structural reforms</b>  |                                   |                      |            |
| <i>Fully funded substitutive model</i><br>Chile: May 1981<br>Bolivia: May 1997<br>Mexico: September 1997<br>El Salvador: May 1998<br>Dominican Republic: 2003-2005   | Individually capitalized accounts | Defined contribution | Private    |
| <i>Fully funded parallel model</i><br>(Workers can choose the system of their preference)<br>Peru: June 1993<br>Colombia: April 1994   | PAYG                              | Defined benefit      | Public     |
|  | Individually capitalized accounts | Defined contribution | Private    |
| <i>Fully funded mixed model</i><br>(Workers pay into both systems simultaneously)<br>Argentina: July 1994<br>Uruguay: April 1996<br>Costa Rica: May 2001<br>Ecuador: 2001  | PAYG                              | Defined benefit      | Public     |
|  | Individually capitalized accounts | Defined contribution | Private    |
| <b>Parametric reforms or no reform</b>   |                                   |                      |            |
| Brazil (General Social Security Regime, private-sector workers): 1999  | PAYG                              | Defined contribution | Public     |
| Brazil (public sector): 2003<br>Costa Rica (PAYG component): 2005<br>Cuba<br>Guatemala<br>Haiti<br>Honduras<br>Nicaragua<br>Panama<br>Paraguay<br>Bolivarian Republic of Venezuela<br>English-speaking Caribbean | PAYG                              | Defined benefit      | Public     |

**Source:** Carmelo Mesa-Lago, "Las reformas de pensiones en América Latina y su impacto en los principios de la seguridad social", *Financiamiento del desarrollo series*, No. 144 (LC/L.2090-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2004; Oliver Paddison, *Social Security in the English-speaking Caribbean* (LC/CAR/L.64), Port of Spain, ECLAC Subregional Headquarters for the Caribbean, 2005.

<sup>5</sup> Apart from the issues highlighted in this chapter, it was projected that structural reforms would stimulate the development of financial markets and economic growth via the accumulation of long-term private saving. The regional experience has shown that, while this type of reform does make a positive contribution to financial-market development and growth, the effect on national saving will depend largely on how the Treasury finances the cost of the transition to a fully funded regime. The magnitude of the impact on the economy's growth rate depends on several other factors, such as macroeconomic stability, inflation, the productive structure, and monetary and exchange-rate policy. It should also be noted that the capital market needs a solid institutional foundation to enable it to channel retirement savings securely into profitable uses.

## Structural reforms

Despite individual variations, the structural reforms introduced by countries in the region can be classified in three broad types: (i) the substitutive type, where a PAYG regime is totally replaced by a fully funded system of individually capitalized accounts; (ii) those that entail the introduction of parallel regimes which maintain the PAYG component, but also incorporate a fully-funded individual-account component as an alternative; (iii) those that establish mixed models that include an individual-account component as a complement to the PAYG regime.<sup>6</sup>

The first Latin American country to undertake structural reform of the substitutive type was Chile in 1981. The public defined-benefit PAYG model was replaced by a single fully funded system with individually capitalized accounts,<sup>7</sup> with the following characteristics: benefits are in direct relation to the contribution effort (defined contribution); the financial management regime involves individually capitalized accounts that are portable between occupations or sectors; and management of the system is entrusted to specialized private-sector managers, who compete for new affiliates. The State regulates and supervises the system's private operators through a Superintendency; and it also plays a distributive role by financing a guaranteed minimum pension for workers who, having fulfilled a contribution requirement, are unable to finance a minimum benefit.<sup>8</sup>

With individual variations, the substitutive model was then applied in four of the region's countries: Bolivia (1997), Mexico (1997), El Salvador (1998) and the Dominican Republic (in the latter the legislation was passed in 2001 but affiliation only began in February 2003).<sup>9</sup> In all cases, further entry to the public PAYG system was closed, i.e. no new affiliates were admitted to the system, which was replaced by a private scheme to which workers were required to affiliate on joining the labour market.

This type of reform was aimed essentially at counteracting the long-term financial sustainability problems of traditional PAYG models by establishing a relationship between the contributions made by each individual and the pensions paid to him/her. A further aim was to reduce the "tax connotation" of the pension-fund contributions paid by affiliates, to encourage an expansion of contributory coverage and to eliminate incentives to under-contribute in the early years of working life, which are characteristic of systems in which the size of the pension depends largely on the final years of contribution (see box IV.4).<sup>10</sup>

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<sup>6</sup> Structural reforms that introduced full-funding components were usually either preceded or accompanied by parametric reforms to the PAYG schemes. The Uruguayan reform of 1995 is representative of this type. Together with the introduction of an individual full-funding component to complement the PAYG regime, the minimum retirement age in the public regime was also altered (for women it was raised from 55 to 60 years) and the contributions threshold was raised from 30 years to 35. One of the key changes, however, involved the way contribution requirements were verified, with "witness evidence" being replaced by the individual's employment record. Initial analyses of these records show that the real frequency of contributions is substantially below the level reported by stakeholders in the previous model. In fact, projections show that a disturbingly small proportion of people will manage to fulfil the new eligibility requirements (Bucheli, Forteza and Ferreira-Coimbra, 2005).

<sup>7</sup> The reform did not affect the armed forces and a number of civil servants who chose to remain in the PAYG regime.

<sup>8</sup> Prior to the reform in Chile, there was a welfare pension programme destined for older adults living in poverty, which depended on the availability of financing from the annual national budget.

<sup>9</sup> The systems in Mexico and the Dominican Republic have multiple management; and in Mexico the benefit can either be defined or undefined: workers who were insured when the reform was passed are entitled on retirement to choose between the pension paid by the public defined-benefit (closed) system and that based on the individually capitalized account of the private system. In the Bolivian reform, competition between managers was generated through regional tenders.

<sup>10</sup> One of the aims of depositing funds in privately managed individual accounts was to insulate them from government management. Most of these arguments were set out in the World Bank report of 1994.

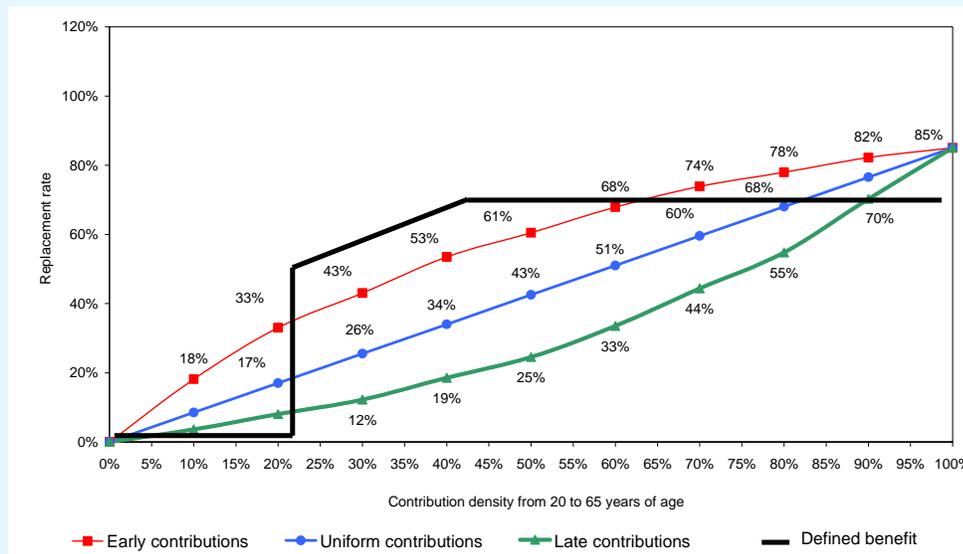
Box IV.4  
**DEFINED BENEFIT, DEFINED CONTRIBUTION, CONTRIBUTION DENSITY  
 AND REPLACEMENT RATES**

In theory, a move from a regime of defined benefits to one of defined contributions brings about significant changes in the incentives to participate in contributory systems. The following figure illustrates the effect on the replacement rate of the average contribution density between 20 and 65 years of age (i.e. the fraction of time for which a person makes contributions) under different scenarios. The thickest line shows the traditional benefit structure of a defined-benefit system, which sets a minimum number of contributions to gain entitlement to a retirement pension; contributions exceeding this amount are rewarded through higher replacement rates up to a given ceiling (which in the example is 70% after 20 years' contributions). The thinner lines show replacement rates in a defined-contribution system under three scenarios that vary depending on when the contributions are made. The highest line represents a scenario in which all contributions are concentrated at the start of the period (thereby taking maximum advantage of compound interest on the contributions); the lowest line corresponds to concentration at the end of the period; and the middle line represents contributions that are uniformly distributed between 20 and 65 years of age.

In the fully funded model there is a direct relationship between contribution density and replacement rates. In contrast, in the defined-benefit system, both workers who do not expect to achieve the minimum density in their working life and those who attain the maximum replacement rate lack incentives to marginally improve their contribution record (the benefit structure is horizontal at the beginning and at the end). In other words, the change of system strengthens the incentive to contribute constantly throughout the life cycle.

Under a defined-contribution model, earlier contributions are rewarded with higher replacement rates. In a defined-benefit system, the moment at which contributions are made is much less important (the only contributions that matter are those used to calculate the base income, usually the 5 or 10 years prior to retirement or the 5 or 10 best years of contributions).

**CONTRIBUTION DENSITY AND REPLACEMENT RATES IN DEFINED-BENEFIT  
 AND DEFINED-CONTRIBUTION MODELS**



In defined-benefit models, the amount of the contributions not considered in the calculation of the base income is practically irrelevant to the pension, which creates a significant incentive to under-contribute in these periods. In the defined-contribution system, larger contributions are always reflected in better pensions, especially when made at an early age. Lastly, under the assumptions of the previous simulation (valid for a female worker contributing 10% of her income and retiring at 65 years old), more than 36 years' contributions (a density of about 80%) are required to achieve a replacement rate of 70% in the intermediate scenario.

**Source:** Eduardo Fajnzylber, "Sistemas de capitalización, densidad de cotizaciones, y cobertura contributiva", working paper, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

By making contributory pensions the actuarial result of capitalizing individual contributions on financial markets, the economic and financial risks are shifted to the workers themselves, and the solidarity elements that are either inherent or explicit in PAYG models disappear.<sup>11</sup> Moreover, as the funds contributed are invested in financial instruments of uncertain return, the worker assumes an additional risk stemming from the volatility of financial markets.<sup>12</sup> Given this risk transfer and loss of solidarity, most substitutive reforms were supplemented by guaranteed minimum pension schemes, financed out of general taxation or through solidarity contributions made by the affiliates themselves. These set a floor to the pensions delivered by the new system to workers satisfying a minimum contribution requirement.

Lastly, the decision to move from an intergenerational contract (PAYG), to full funding in individually capitalized accounts necessarily requires a decision to be made regarding commitments acquired in the past with current pensioners affiliated to the PAYG system, and with workers who made contributions to this system but then decided to move to the new one.<sup>13</sup> To the extent that these commitments become part of workers' acquired rights, they create a pension deficit because there is an obligation to continue paying pensions to retirees from the PAYG system and to recognize past contributions made by active workers who have moved to the new system even after contributions from the latter group are no longer received. This initial fiscal pressure or "transition cost" generated by the move from PAYG to a fully funded model can become substantial in the short term. In some of the region's countries, the deficit has actually destabilized the macroeconomic situation and, hence, the capacity to fulfil pension obligations.

The first structural reforms to follow those introduced by Chile (Peru 1993, Colombia 1994) were also based on the model of individually capitalized accounts. This model was only partially implemented through parallel reforms, however. The public system was not closed but was reformed (thoroughly in the case of Colombia but only partially in the case of Peru); and a new private system was created, so that the two competed with each other to capture affiliates.<sup>14</sup>

This choice basically reflects fiscal and political considerations. As only a proportion of affiliates move to the fully funded regime, the short-run fiscal cost of transition is less (compared to the option in which all workers move to the capitalized system). On the other hand, as workers themselves take the affiliation decision, political opposition to the reforms tends to be reduced. This can also be seen as a way of limiting the shift of demographic, economic and financial risks to the affiliate, which is an inherent feature of substitutive reforms.

The mixed structural reform model was adopted in four countries, including Argentina (1994), Uruguay (1996), Ecuador (2001) and Costa Rica (2001).<sup>15</sup> This includes a public system that is not closed and provides a basic pension, together with a private system offering a supplementary pension.

Reforms based on a mixed model can be seen as a way of gradually introducing the principle of equivalence between contributions and benefits, which makes it possible to maintain control over

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<sup>11</sup> In all substitutive reforms, insurance against risks of disability or early death were maintained, funded through premiums paid by the affiliates themselves.

<sup>12</sup> One way to mitigate the financial risk is to place special restrictions on the level of risk allowed in the investment of funds belonging to individuals who are close to retirement age. An example of this is the current pension regime in Chile, in which funds belonging to such individuals can only be invested in portfolios that hold a maximum of 60% in variable return instruments.

<sup>13</sup> See Holzman (1997), ECLAC (1998), Bravo and Uthoff (1999).

<sup>14</sup> In the Peruvian model, labour-market entrants can join the system of their choice, and they are allowed to move from the public to the private system. The reverse process is only permitted for justified reasons, however. In the Colombian model, on the other hand, it is possible to move between both systems, subject to a minimum of five years permanency.

<sup>15</sup> The Argentine model combines the mixed and parallel systems, since part of the contribution is mandatorily destined for a public defined-benefit PAYG scheme; but, with the supplementary component it is possible initially to choose between the public model or a scheme of individually capitalized accounts. In 2001, Ecuador passed legislation creating a mixed regime, but this law has not yet been implemented.

the fiscal cost of the transition and reconcile different political positions.<sup>16</sup> Moreover, society defines how much solidarity it wants to retain in the system and how much risk to shift to the worker through the relative importance given to the PAYG component. As in the case of parallel reforms, however, the PAYG model still needs to be reformed to ensure its financial sustainability through time.

## Parametric reforms

Most countries in the region have chosen to maintain public PAYG systems. In some cases, changes have been made in key parameters of system design in order to align the contributions that are received more closely with the benefits paid out—both at the aggregate level and in the short and medium terms—without incurring the fiscal cost of transition involved in a structural reform.

In December 2003, the Brazilian Congress approved a reform of civil service pension programmes including a process of unification and standardization (Mesa-Lago, 2004; MPAS, 2002b; Schwarzer, 2004). In late 2002 the Bolivarian Republic of Venezuela passed the Organic Law on the Social Security System (LOSSS), which stipulates that the system will continue to be defined-benefit, PAYG, and publicly managed. Both the United States and Canada have made gradual parametric reforms, to respond to demographic pressures on their PAYG systems and to guarantee financial balance in their social security systems. The structural principles of the models in both countries have remained unchanged thus far, however.<sup>17</sup>

In English-speaking Caribbean countries, PAYG defined-benefit pension systems have hardly been altered (see table IV.3); and, given their relatively short history and low demographic dependency rate, they remain solvent.<sup>18</sup> In fact, these countries have managed to accumulate reserve funds amounting on average to 19% of regional GDP. Nonetheless, the long-term financial sustainability of these regimes is threatened by projected changes in their demographic structures (less imminent but faster than in the rest of the region), high rates of unemployment, rising indices of informality, and emigration from the region to the rest of the world.<sup>19</sup>

A special case of parametric reform is the Brazilian reform of the general social security regime for private-sector workers in 1999. The introduction of actuarial criteria succeeded in forging a closer relation between the present value of individual contributions and the expected value of pensions paid. The benefit calculation rule was replaced by an equation that includes labour incomes, the time of the contribution, age, and life expectancy at retirement. In order to keep track of labour incomes, a record began to be maintained of the individual contributions private-sector workers pay into the public system, using the average of the highest 80% of real insurable wages as a calculation factor.<sup>20</sup>

Parametric reforms aimed at restoring the financial balance of PAYG systems can be divided into two basic types: those that tend to produce a closer relation between an individual's contributions to the system and the pension received, on the one hand; and those that aim to raise revenue, reduce benefits or restrict access to benefits, on the other.

<sup>16</sup> In the Costa Rican reform of 2001, an explicit strategic objective was gradual transition to the defined contribution scheme. Initially, contribution to the public defined-benefit PAYG system was unchanged, thanks to the fact that the funded model was introduced on a complementary basis. This also made it possible to avoid the transition cost arising from the move and the need to recognize past contributions.

<sup>17</sup> In Canada, the PAYG system was reformed (the Canadian Pension Plan) by progressively increasing the contribution rate from 3.6% in 1986 to 9.9% in 2003, and establishing a new policy for investment of the reserve fund. These adjustments are expected to ensure financial viability until at least 2075 (Velloso and Vézina, 2005). Meanwhile, actuarial studies of the United States social security system suggest that an increase of between one and two percentage points in the contribution rate would be sufficient to achieve actuarial balance for the next 75 years (Velloso, 2005).

<sup>18</sup> See Paddison (2005) for further details on pension systems in the English-speaking Caribbean.

<sup>19</sup> Suriname, Guyana, Haiti, Jamaica and Trinidad and Tobago have the world's highest emigration rates, and over half of the 30 countries with highest emigration belong to the Caribbean region (Paddison, 2005).

<sup>20</sup> This rule is only applied to pensions based on time of contribution or length of service, and is optional for retirement based on age. For further information on this reform, see Diniz Cotta (2005) or Pinheiro and Paiva (2000).

Table IV.3

## CHARACTERISTICS OF NATIONAL SOCIAL SECURITY SYSTEMS IN THE ENGLISH-SPEAKING CARIBBEAN

| Countries                        | Maximum contributory income <sup>a</sup> | Pensions in relation to insurable wages (%) |      | Replacement rate (%) |          |      | Minimum contribution (number of weeks) | Retirement age  |                 | Management commissions as a percentage of contributions paid (2003) | Life expectancy at birth (years) |           |           | Real rate of return on reserve funds |         | Percentage of reserve funds invested |
|----------------------------------|--|---|------|----------------------|----------|------|--|-----------------|-----------------|---|----------------------------------|-----------|-----------|--------------------------------------|---------|--------------------------------------|
|                                  |  | Mean  | Min. | 10 years             | 30 years | Max. |  | Normal          | Early           |   | 2000-2005                        | 2025-2030 | 2045-2050 | 10 years                             | 5 years |                                      |
| Anguilla                         | 2.02                                     | 30.6  | 26.3 | 30                   | 50       | 60   | 250                                    | 65              | ...             | 22.8  | ...                              | ...       | ...       | 2.5                                  | 1.5     | 91.8                                 |
| Antigua and Barbuda              | 1.88                                     | 22.2  | 6.3  | 25                   | 45       | 50   | 350                                    | 60              | ...             | 17.7  | ...                              | ...       | ...       | 0.8                                  | 1.5     | 44.4                                 |
| Bahamas                          | 1.36                                     | 25.4  | 16   | 30                   | 55       | 60   | 150                                    | 65              | 60              | 19.9  | 69.4                             | 75.7      | 77.3      | 4.8                                  | 4       | 92.4                                 |
| Barbados                         | 2.09                                     | 49  | 30.6 | 40                   | 60       | 60   | 500                                    | 65              | 63              | 6.1   | 77.2                             | 79.8      | 81.4      | 5.2                                  | 5.2     | 82.4                                 |
| Belize                           | 1.52                                     | 25.3  | 22.4 | 30                   | 55       | 60   | 500                                    | 65              | 60              | 30.5  | 74.4                             | 77.5      | 79.7      | 7.4                                  | 7.5     | 94.5                                 |
| British Virgin Islands           | 1.42                                     | 21.4  | 7.5  | 30                   | 50       | 60   | 500                                    | 65              | ...             | 11.9  | ...                              | ...       | ...       | 2.2                                  | 2.8     | 92.8                                 |
| Dominica                         | 3.15                                     | 28.3  | 6.8  | 30                   | 55       | 70   | 500                                    | 60              | ...             | 16.7  | ...                              | ...       | ...       | 4.7                                  | 4.6     | 77                                   |
| Grenada                          | 2.07                                     | 24.5  | 12   | 30                   | 50       | 60   | 400 <sup>b</sup>                       | 60              | ...             | 12.4  | ...                              | ...       | ...       | 5                                    | 4.9     | 92.1                                 |
| Guyana                           | 2.1                                      | 28.5  | 27.3 | 40 <sup>b</sup>      | 55       | 60   | 750                                    | 60              | ...             | 15.8  | 62.4                             | 64.1      | 71.2      | 4.8                                  | 4.1     | 95.3                                 |
| Jamaica                          |  |   |      | <sup>f</sup>         |          |      |  | 70 <sup>e</sup> | 65 <sup>e</sup> | 13  | 75.7                             | 79        | 80.8      | 3.5                                  | 9.8     | 95.5                                 |
| Montserrat                       | 1.26                                     | 17.1  | 8.4  | 30                   | 50       | 60   | 350 <sup>c</sup>                       | 60              | ...             | 48.8  | ...                              | ...       | ...       | 2.4                                  | 2.4     | 96.7                                 |
| Saint Kitts and Nevis            | 3.07                                     | 28.4  | 11.8 | 30                   | 55       | 60   | 500                                    | 62              | ...             | 14.6  | ...                              | ...       | ...       | 3.2                                  | 4       | 94.9                                 |
| Saint Lucia                      | 3.41                                     | 39  | 13.7 |                      | 58       | 60   | 576 <sup>d</sup>                       | 61              | 60              | 13.3  | 73.8                             | 77.2      | 79.5      | 3.8                                  | 4.1     | 96                                   |
| Saint Vincent and the Grenadines | 3.08                                     | 29.9  | 19.4 | 30                   | 50       | 60   | 325 <sup>c</sup>                       | 60              | ...             | 16.7  | ...                              | ...       | ...       | 4.3                                  | 5.6     | 91.6                                 |
| Trinidad and Tobago              | 1.25                                     | 15.8  | 37   | <sup>g</sup>         |          |      | 750                                    | 65              | 60              | 6.9   | 74.8                             | 78.6      | 80.5      | 4.7                                  | 4.7     | 93.4                                 |
| Turks and Caicos Islands         | 1.69                                     | 19  | 14.1 | 30                   | 55       | 60   | 500                                    | 65              | 60              | 21.1  | ...                              | ...       | ...       | 1.6                                  | 0.9     | 87.5                                 |

Source: Oliver Paddison, *Social Security in the English-speaking Caribbean* (LC/CAR/L.64), Port of Spain, ECLAC Subregional Headquarters for the Caribbean, 2005.

<sup>a</sup> Ratio between maximum and average insurable wage. <sup>b</sup> After 15 years. <sup>c</sup> Rising to 500 in annual steps of 25. <sup>d</sup> Starts from 144 months, increasing by 12 months every three years until 180 is reached on 1 January 2012. <sup>e</sup> The female retirement age is 60 years. <sup>f</sup> Flat-rate pensions, plus earnings-related proportion. <sup>g</sup> Pension calculation based on the average income bracket in which contributions were made. <sup>h</sup> Increasing to 500 in 2008.

The first category includes changes aimed at increasing the number of contributions considered in the calculation of the base income used to determine pensions, together with rules that penalize early retirement and reward later retirement. A specific example of this type of reform, introduced in Nordic countries, is the notional accounts model, in which benefits are calculated on the basis of the complete contribution history (indexed to a uniform systemic rate of return) and life expectancy at retirement. This enables pensions to adapt automatically to demographic changes, such as longer life expectancy, without the need to raise the legal age of retirement (see box IV.5).<sup>21</sup> One of the problems with parametric reform of PAYG systems is that programmed reforms are often hard to implement because of political pressures (see box IV.2). From this standpoint, introducing individual notional savings accounts has the advantage that adjustments are made automatically. As in the case of structural reforms, this type of reform should increase incentives to participate actively in contributory systems and discourage under-contributing in the early stage of the life cycle. On the other hand, they tend to reduce the degree of solidarity inherent in the system.

#### Box IV.5 NOTIONAL ACCOUNT MODELS

A notional accounts model is a PAYG pension system in which the defined-benefit principle is replaced by one of defined contributions.

Pension contributions are noted in individual accounts. The balances on those accounts are increased according to a rule that establishes a systemic rate of return and when new contributions are made by the worker or employer. In models involving individually capitalized accounts, the rate of return to which contributions are indexed is the financial return actually obtained on the portfolio in which the savings are invested. In contrast, in notional accounts in their most generic form, the internal rate of return ( $\alpha$ ) is a function of labour productivity (measured by the rise in real wages ( $g$ )), the rate of growth of the labour force ( $\lambda$ ) and an actuarial adjustment factor that tends to lead the system to a long-term state of financial balance ( $\rho$ ). The latter is equivalent to the quotient between the present values ( $PV$ ) of systemic assets ( $A$ ) and liabilities ( $L$ ) minus one, such that:

$$\alpha = g + \lambda + \rho = g + \lambda + \left( \frac{PV(A_t)}{PV(L_t)} - 1 \right)$$

The pension takes the form of a life annuity paid monthly until the beneficiary's death. Its amount is calculated as the balance on the account at retirement, divided by the individual's estimated life expectancy at that time. A minimum retirement age is usually established, and contributions made after that age continue to increase the balance on the account and enhance the value of the pension. In countries that have introduced models of this type, gender solidarity is often promoted by using common mortality tables for men and women, although specific to each cohort of retirees.

Thus defined, a notional accounts model encourages long-term systemic financial stability through the influence of life expectancy at retirement in the benefits calculation. Also contributing to this aim is the fact that the internal rate of return takes account of economic and demographic features, together with the adjustment factor, which makes it possible to correct actuarial imbalances in the system.

In notional accounts models, the only form of financial saving consists of reserve funds, which, among other reasons, are established to accumulate surplus contributions paid by the most numerous worker cohorts until their retirement.

A common criticism of defined-benefit models is that stipulation of a legal retirement age after which the maximum benefit can be received (provided the contributions requirement has been fulfilled) creates a significant disincentive to continue working and contributing to the system. The incorporation of notional accounts in PAYG systems, and also in fully funded systems, has a direct repercussion on this labour-market dynamic basically through two channels. First, the method for calculating benefits (based on the balance on the individual account and life expectancy at retirement) makes the retirement age flexible and allows affiliates to draw partial retirement pensions. Individuals who wish to keep working beyond the minimum retirement age can continue to contribute and increase the size of their funds; or else they can reduce the number of hours they work and offset the drop in their income by drawing partial retirement pensions, in which part of the notional balance is converted into a life annuity. Moreover, by being based on individual accounts with no minimum contribution requirements (as is usually the case in defined-benefit systems) free mobility between occupations, economic sectors, regions or countries is encouraged with no loss of past contribution rights.

**Source:** R. Holzmann and E. Palmer, "The status of the NDC discussion: introduction and overview", *Pension Reform through NDCs: Issues and Prospects for Non-Financial Defined Contribution Schemes*, Washington, D.C., World Bank, 2005.

<sup>21</sup> The Brazilian reforms of 1999, which incorporated the complete record of contributions and life expectancy at retirement, are an approximation to the Nordic notional accounts models.

The second type of parametric reform includes those that generally increase contributions to the system (or reduce the scale of benefits paid by it) by increasing contribution rates, changing pension indexation mechanisms, and raising the legal retirement age (to reflect greater longevity) or the number of contributions needed for entitlement to a retirement pension.

In terms of the principles set out in this chapter —and provided there are mechanisms that allow all workers to share the burden of making public PAYG schemes financially viable— the use of mechanisms that tend to sacrifice coverage for sustainability should be approached cautiously.

## Key results of the reforms

This section analyses the key results of the structural reforms undertaken in the region in terms of expanding contribution coverage, solidarity in the resultant pension regimes, the fiscal effects of the transition to funded systems and the degree of competition in pension-fund-management markets.

### Coverage

Contrary to expectations, recent data show that the introduction of individual funding components has not elicited higher rates of contributory participation, which reflects the low long-term saving capacity of large segments of the population. In the absence of reforms to strengthen the non-contributory components of pension systems, the least protected groups (especially women) will either remain excluded from contributory systems or else will receive low-quality pensions because of their relatively low contribution frequency and, in the case of the poorest quintiles, a tendency to delay contributions until the later stages of working life.

Despite the closer correlation between contributions and benefits in countries that have undertaken structural reforms, no significant or systematic increases in pension coverage rates have been observed, but instead a tendency towards stagnation (see figure IV.4). Of the countries included in the figure, only Colombia shows signs of a significant improvement in coverage following the 1994 reform in that country. In fact, in half of all cases the reform was followed by a drop in this indicator. In the case of Chile, coverage in 1999 is practically identical to that of the year preceding the reform, while Argentina exhibits steadily declining coverage since 1987.

The level and quality of coverage of a contributory system depends on the amount and frequency of the contributions made by each individual participant.<sup>22</sup> The concept of contribution density is normally used to measure the frequency of a person's contributions throughout his/her working life. This is calculated as the number of contributions made divided by the number of months in which the individual was of working age.

The main conclusion to be drawn from studies of contribution densities in the region is that a large proportion of participants in contributory systems are in practice under-insured, even in countries with the highest pension coverage.<sup>23</sup> This means that their contribution densities are below the threshold needed to receive a retirement pension in defined-benefit models or result in lower-quality pensions in funded systems.<sup>24</sup> In some cases clear gender differences have been detected.<sup>25</sup>

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<sup>22</sup> In defined-benefit regimes, entitlement to a pension requires contributions over a minimum period (which in most cases ranges between 10 and 30 years). Once the minimum requirements have been satisfied, replacement rates usually rise with the number of contributions made (see box III.3). By contrast, in defined-contribution regimes the pension depends on the (indexed) sum of all contributions made, so people who have significant contribution gaps (periods in which they did not contribute) are likely to accumulate insufficient balances and receive pensions that are low or time-limited.

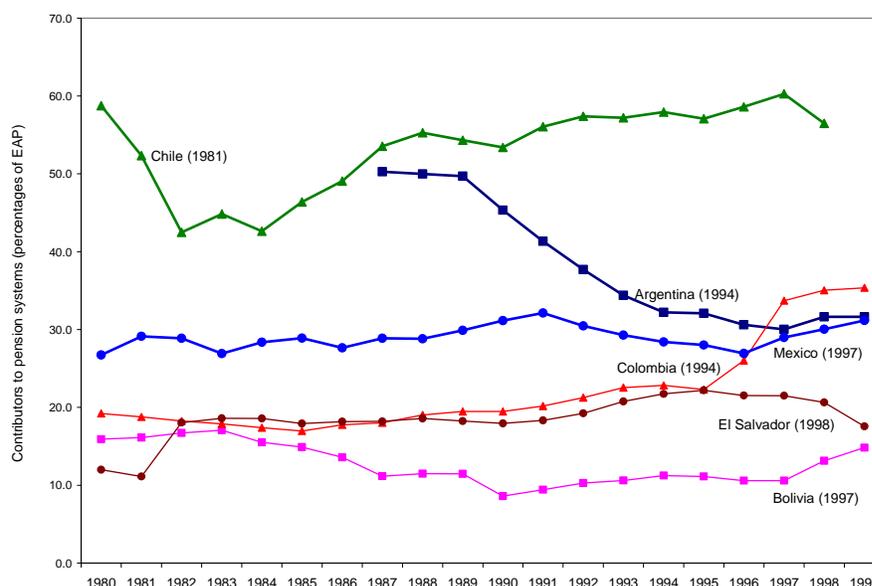
<sup>23</sup> See, among others, Bertranou and Sánchez (2003) in the case of Argentina, Arenas de Mesa, Llanes and Miranda (2004) or Berstein, Larraín and Pino (2005) with regard to Chile, and Lagomarsino and Lanzilotta (2004) or Bucheli, Forteza and Ferreira-Coimbra (2005) for Uruguay.

<sup>24</sup> In both Argentina and Chile the average contribution density of affiliates is roughly 50%, a figure far below those envisaged by the creators of fully funded systems. The contribution density of Uruguayan affiliates is slightly higher at 60%, but still way below the 35-year threshold giving entitlement to a common retirement pension at 60 years of age under the country's new public system.

<sup>25</sup> Male Chilean workers contribute during roughly 59% of their working lives, but their female counterparts only contribute during 41%.

All studies reveal socioeconomic differences in contribution profiles, with the highest-income sectors displaying significantly higher densities than lower-income groups (especially women). The contribution profile of the latter tends to start at a very low level and gradually rise during their working life,<sup>26</sup> which is particularly relevant when moving from a defined-benefit to a defined contribution system (funded or notional) where the time at which contributions are made is decisive for the quality of the pensions received.

Figure IV.4  
**LATIN AMERICA AND THE CARIBBEAN: TREND OF CONTRIBUTIONS TO PENSION SYSTEMS IN SIX COUNTRIES THAT HAVE MADE STRUCTURAL REFORMS**  
*(Pension-system contributors as a percentage of the economically active population)*



**Source:** Truman Packard, "Is there a positive incentive effect from privatizing social security? Evidence from pension reforms in Latin America", *Policy Research Working Paper*, No. 2719, Washington, D.C., World Bank, 2001.

These results concur with studies on the gender effect of pension reforms, which show that characteristics relating to demography (longer female life expectancy), labour markets (wage discrimination and more usual participation in informal and temporary jobs), and the design of funded models (especially the use of gender specific mortality tables) tend to create wide discrepancies in terms of access to and the quality of contributory benefits received by male and female workers in Latin America and the Caribbean (ECLAC 2004c).

### Solidarity

Apart from being ineffective in extending pension coverage to sectors that have traditionally been excluded from the formal economy, the adoption of fully funded models through individually capitalized accounts eliminated much of the solidarity inherent in PAYG systems, and tended to reproduce the inequities of working life in the form of pension inequities (ECLAC 2000c). To rectify this situation, guaranteed minimum pension programmes or contribution subsidies were introduced, but these have not succeeded in reaching people with least contributory capacity. In contrast, the non-contributory pension programmes of Brazil or Bolivia have managed to take

<sup>26</sup> In Chile the three lowest quintiles of the female income distribution (i.e. those earning the lowest 60% of incomes) register densities below 40% virtually throughout their working lives, whereas males in the second quintile display systematically higher densities (Bernstein, Larraín and Pino, 2005).

citizen solidarity to the most unprotected sectors, thereby making it possible to prevent poverty in old age.

Given this loss of contributory solidarity, countries that made structural reforms mostly chose the mechanism of State-guaranteed minimum pensions which pay a minimum monthly benefit to workers who, despite having contributed for a minimum number of years, have exhausted the funds accumulated in their individual accounts. Examples are the funded components included in Chile, Colombia, Costa Rica (in the basic collective funded regime), the Dominican Republic, El Salvador, Mexico, Nicaragua, Peru and Uruguay.<sup>27</sup>

Although these mechanisms can reduce part of the risk arising from low rates of return on pension funds —and to some extent compensate for gender differences arising from wage discrimination against women, their lower retirement age and longer life expectancy— they only improve the quality of coverage for affiliates who succeed in accumulating a significant number of contributions (generally 20 years), and thus exclude the vast majority of workers who either participate very little in contributory systems or not at all.<sup>28</sup>

A less common solidarity-based alternative targeting low-income affiliates consists of mechanisms for raising the level of contributory pensions through State-subsidized contributions. Examples of this type include the Social Quota Programmes in Mexico and the Solidarity Pension Fund in Colombia.<sup>29</sup> In the first case, a fixed State contribution is established per day of contribution by all affiliates to the private system, whereas in the second case, the fund partly subsidizes the contributions made by low-income workers, financed jointly by the State and solidarity contributions made by higher-income affiliates. As subsidies depend on payment into contributory systems in both cases, workers who are outside formal models are once again excluded.

Apart from the Brazilian rural pensions programme mentioned above, the main recent effort to compensate for the loss of solidarity resulting from structural reforms through the non-contributory channel consists of the solidarity bond (Bonosol) introduced in Bolivia in 1997. This provides a monthly lifetime benefit to the entire population over 65 years of age, with no requirements on contributions or evidence of economic means. As this scheme is financed through the capitalization of privatized public enterprises, it is in principle temporary (restricted to individuals of over 21 years of age before 31 December 1995). Be that as it may, Bonosol has brought about a radical change in pension coverage for Bolivia's older population (see figure IV.5). In fact, the initiative demonstrates the potential of a universal pension policy to extend coverage. Sustainable funding for this type of programme may prove prohibitive for economies in the region, however.

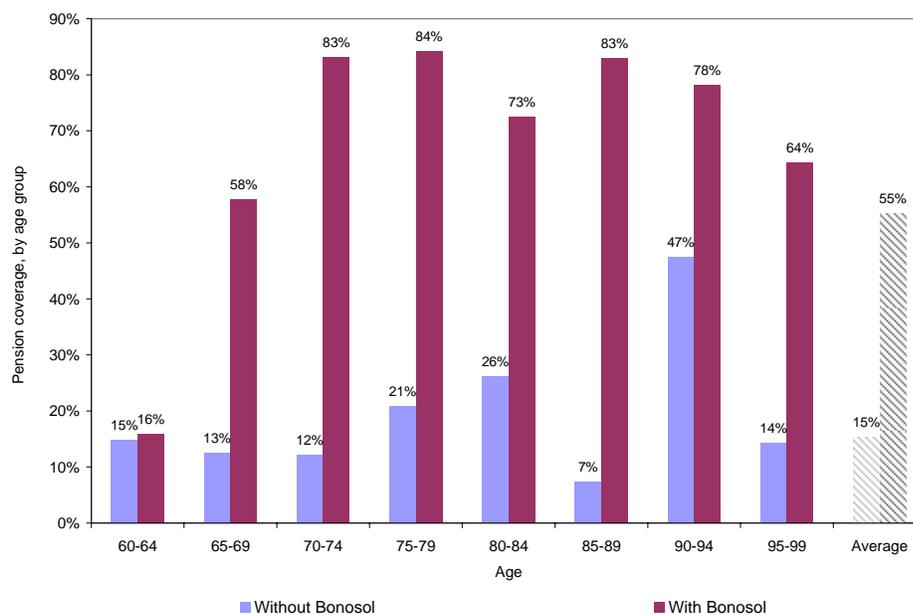
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<sup>27</sup> In the case of Argentina, the universal basic benefit (PBU) was established for all affiliates with 30 years of service and eligible contributions. Unlike minimum pensions, this benefit supplements self-financed pensions as from 65 years of age (60 in the case of women).

<sup>28</sup> The most recent projections by the Chilean Superintendency of Pension Fund Managers estimate that in 2025 only 5% of affiliates will be entitled to the minimum State-guaranteed pension, while roughly 50% will have accumulated insufficient funds and will not attain the 20 years' contributions required for entitlement to this benefit.

<sup>29</sup> Durán-Valverde (2005) describes and analyses a similar proposal to extend pension coverage in Costa Rica.

Figure IV.5  
**IMPACT OF BONOSOL ON PENSION COVERAGE IN BOLIVIA, 2002**  
*(Percentage of individuals receiving income from retirement or other pensions, with or without Bonosol)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Household Survey of Bolivia, November-December 2002.

### Financial sustainability

In principle, capitalization-oriented reforms to pension systems tend to improve long-term fiscal solvency. Nonetheless, recent experience has shown that, in the short and medium term, financing the transition of a structural reform in the region, combined with the large deficits accumulated by inadequately funded PAYG systems and the presence of high-cost special regimes, jeopardize the financial viability of pension reforms and may undermine protection for the older adults that the reform seeks to guarantee. While part of these costs can be controlled through parametric, mixed or parallel reforms, most are impossible to avoid in the short and medium term. Furthermore, the growing importance of the non-contributory component as a key mechanism for extending coverage poses additional challenges for sustainable financing.

The level and time distribution of the transition cost arising in a structural reform depends directly on the way in which the PAYG regime is replaced by capitalization.<sup>30</sup> A structural reform of the substitutive type involves denying new affiliates admission to the PAYG system and the transfer (generally voluntary) of most affiliates from the PAYG system to the funded scheme. In this context, the transition immediately generates a high cost, which, as shown in box IV.6, can last for many years. In parallel-type structural reforms, PAYG systems remain open to new affiliates, thereby making it possible to dilute the cost arising when affiliates transfer en masse to the funded regime, although control over the pace of transition is partly lost. Structural reforms of the mixed type achieve the same objective, making the cost of transition gradual, but at a pace determined by the size of the funded component (i.e. the proportion of the individual contribution that is placed in individual savings accounts).

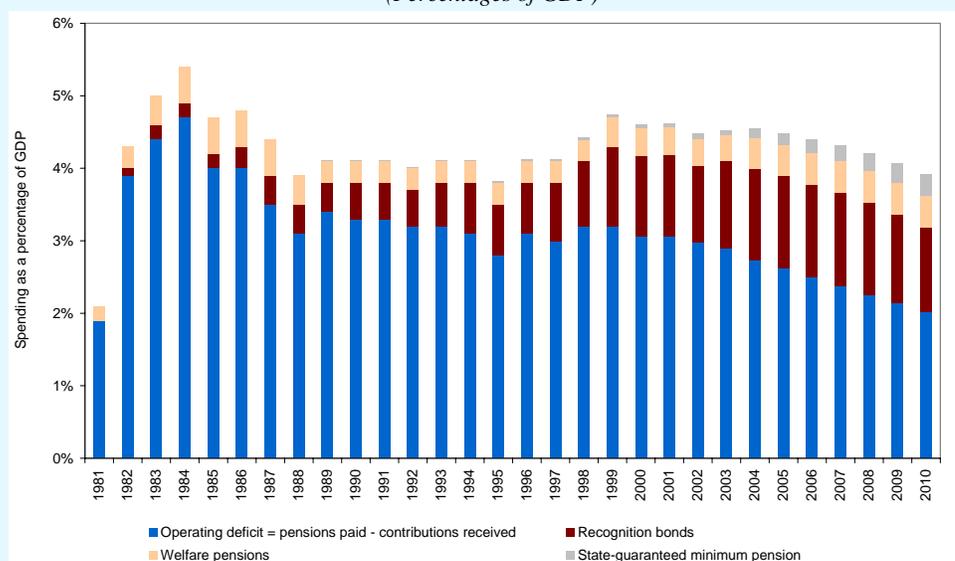
<sup>30</sup> The transition cost also depends on the characteristics of the initial PAYG system itself, such as degree of coverage, age distribution and generosity of benefits (Bravo and Uthoff, 1999). In the Chilean case, this translates into an annual cost of roughly 3.9% of GDP in the first 30 years.

### Box IV.6 FISCAL COST OF TRANSITION UNDER A SUBSTITUTIVE REFORM: THE CASE OF CHILE

The fiscal cost of transition from a PAYG regime to a system of individually capitalized accounts is usually divided in two basic parts: the operating deficit and recognition bonds. The operating deficit of the public pension system is the shortfall between pensions paid to retirees from the PAYG regime, at a given point in time, and the contributions made by workers who remain in this regime (in the absence of reserve funds). The past contributions of workers who move to the funded system are transformed into public-debt instruments, known as “recognition bonds”, which are payable on retirement. This operational deficit generates pressure on public expenditure as soon as workers start to move to the new regime, whereas the expenditure on recognition bonds is deferred until the first pensioners from the funded system start to retire.

The following figure illustrates the evolution of the different parts of the civil pension deficit in Chile, which, in addition to the operating deficit and the expenditure on recognition bonds, includes expenses of the non-contributory pension programme (welfare payments for old-age, physical or mental disability), and the new system’s minimum guarantees programme (minimum pensions). As the figure shows, the operating deficit peaked at 4.7% of GDP three years after the start of the reform and then gradually began to decline; by 2010 it is expected to represent 2% of GDP and it should have disappeared around 2040. Expenditure arising from recognition bonds has been growing throughout the period and currently stands at 1.3% of GDP. Although this is projected to remain high throughout the coming decade, it should also decline gradually until 2040. The sum of the operating expense and expenditure on recognition bonds averaged 3.9% of GDP in the first 30 years of operation, peaking at 4.9% of GDP three years after the start of the reform.

#### BREAKDOWN OF THE CHILEAN CIVIL PENSION DEFICIT (Percentages of GDP)



As the welfare pension programme is non-contributory and discretionary, expenditure levels have remained virtually constant in GDP terms. Lastly, expenditure on minimum pensions began to affect the fiscal budget with several years delay, possibly due to its relatively limited nature (affiliates with at least 20 years’ contributions who have not accumulated sufficient funds), and the fact that this programme requires pensioners having programmed withdrawals (the vast majority of those entitled to this benefit) to have exhausted their funds before producing a fiscal disbursement. Once transition costs have been overcome, all that will remain will be to finance the pension deficit of the Armed Forces (currently around 1.3% of GDP) and the State effort to prevent poverty through the minimum and welfare pensions.

**Source:** A. Arenas de Mesa, M.C. Llanes and F. Miranda Bravo, “Protección social efectiva, calidad de la cobertura y efectos distributivos del sistema de pensiones en Chile,” Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

In contrast, by not interrupting the intergenerational contract, parametric reforms to PAYG regimes allow the financial situation of public systems to be improved without the fiscal cost of transition arising from structural reforms. Nonetheless, parametric reforms face major political problems in gaining legislative approval, because the changes involved usually have unpopular consequences. In addition, there is still the possibility of establishing special regimes, whose effects are not confined to financial viability but may also influence the level of equity within the system.

In general it is not easy to estimate the public-finance consequences through time of the transition cost under a structural reform, and specific studies exist for certain countries only. Nonetheless, demographic techniques make it possible to calculate the present value of State liabilities, which are equivalent to the present value of the cost of meeting all commitments arising from hypothetically replacing a PAYG system with a fully funded scheme of individually capitalized accounts (Bravo and Uthoff, 1999). Table IV.4 shows the result of this estimate for 20 of the region's countries, and the type of reform adopted. The cost of transition to a funded model has been fundamental in the analysis of reform alternatives: apart from Chile, all countries with relatively high liabilities in present value terms have chosen non-substitutive reform models, either incorporating a complementary capitalization pillar (mixed or parallel model), or undertaking parametric reforms.

Table IV.4  
**HYPOTHETICAL TRANSITION COST AND CHOICE OF REFORM**  
(Present value of State liabilities as percentages of GDP)

| Countries                      | Hypothetical transition cost | Type of reform               |
|--------------------------------|------------------------------|------------------------------|
| Very high cost                 |                              |                              |
| Argentina                      | 305.4                        | Mixed model                  |
| Uruguay                        | 289.4                        | Mixed model                  |
| Brazil                         | 201.6                        | Parametric reforms           |
| High cost                      |                              |                              |
| Cuba                           | 151.4                        | Parametric or without reform |
| Panama                         | 145.3                        | Parametric or without reform |
| Chile                          | 131.0                        | Substitutive model           |
| Costa Rica                     | 93.9                         | Mixed model                  |
| Colombia                       | 63.0                         | Parallel model               |
| Low cost                       |                              |                              |
| Peru                           | 44.5                         | Parallel model               |
| Mexico                         | 37.0                         | Substitutive model           |
| Venezuela (Bolivarian Rep. of) | 36.6                         | Parametric or without reform |
| Paraguay                       | 36.4                         | Parametric or without reform |
| Nicaragua                      | 32.9                         | Parametric or without reform |
| Bolivia                        | 30.9                         | Substitutive model           |
| Guatemala                      | 25.5                         | Parametric or without reform |
| Dominican Republic             | 21.5                         | Substitutive model           |
| Very low cost                  |                              |                              |
| Ecuador                        | 19.1                         | Mixed model                  |
| Honduras                       | 15.4                         | Parametric or without reform |
| El Salvador                    | 8.7                          | Substitutive model           |
| Haiti                          | 4.3                          | Parametric or without reform |

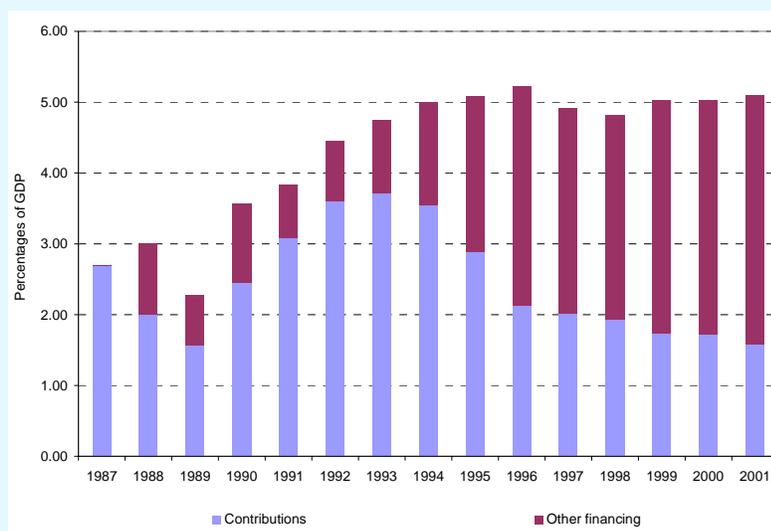
**Source:** J. Bravo and A. Uthoff, "Transitional fiscal costs and demographic factors in shifting from unfunded to funded pension in Latin America", *Financiamiento del desarrollo series*, No. 88 (LC/L.1264-P/I), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 1999. United Nations publications, Sales No. E.99.II.G.38.

It should be noted that, even after the reform, serious design problems can still persist. Such problems can generate a significant fiscal burden and add to budgetary pressures, particularly when the new design fails to correct the imperfections of the old system, when ongoing benefits fail to match up with contributions (see the case of Colombia in box IV.2), or when predicted transition costs are underestimated, thereby aggravating the fiscal situation more than anticipated. Box IV.7 shows the effect that the structural pension reforms introduced in the mid-1990s had in terms of the 2001 crisis in Argentina.

## Box IV.7

**FISCAL LIABILITIES IN THE ARGENTINE PENSION SYSTEM AFTER 2001**

In the 1980s, the effects of a deep economic crisis began to be felt in the different components of the Argentine social security system. Initially, falling real wages withdrew funding from the sector; then, the prolonged crisis spurred in the early 1990s, a drastic rise in the unemployment rate. The combination of a smaller contributory base and an excessively generous benefits model (82% of the wage of the last three years' contributions) meant that debate on reforms to the system could no longer be delayed. In the middle of the convertibility period and following multiple piecemeal changes, a structural reform was initiated in 1993 that introduced a mixed system with an option to contribute funds to a new fully funded scheme. The fiscal costs of partial transition to this regime of individual accounts was aggravated by two policies applied since the mid-1990s that added considerably to the growing pension deficit, as shown in the following figure. The first was a decrease in payroll taxes paid by the private sector ("fiscal devaluation" aimed at shielding the Argentine economy from a loss of external competitiveness arising from appreciation of the real exchange rate); the second was a gradual transfer of most of the provincial pension funds (along with their deficits) to the central government. According to Cetrángolo and Grushka (2004), the pension deficit as of 2000 (equivalent to 3.3% of GDP) can be broken down as follows: 45.9% representing contributions to the individually funded system, 40.6% relating to the reduction in employer contributions, and 13.5% linked to other causes, mainly the transfer from provincial funds. As a result of these factors, the pension system was one of the elements most frequently cited as a contributing factor to the crisis of late 2001.

**ARGENTINA: PENSION BENEFITS AND THEIR FINANCING, 1987-2001**

The funding crisis in the pension system was accompanied by a crisis in coverage, with pension incomes received by persons over 65 years of age falling annually by over one percentage point (from 77% in 1994 to 66% in 2003). In order to strengthen the fiscal situation of the system, the 1993 reform made significant parametric changes to the PAYG model: the retirement age was raised by five years, the number of years considered in the calculation of the base salary was increased, and the minimum number of contributions giving entitlement to a retirement pension was gradually raised (from 20 to 30 years). These adjustments made access to benefits more difficult and exposed the weakness of the contributory model, against a backdrop of a labour market suffering from high unemployment and structural informality. Lastly, the growing need to finance contributory pensions out of general funds rendered unviable any non-contributory initiative to extend pension coverage to the most needy. The new funded regime has been affected by a high level of market concentration among pension-fund managers, high commissions, and above all, an investment portfolio dominated by government bonds. The latter reflects the primary means of financing the transition to the funded regime and, at the same time, the high level of exposure to political pressures.

**Source:** O. Cetrángolo and C. Grushka, "Sistema previsional argentino: crisis, reforma y crisis de la reforma", *Financiamiento del desarrollo series*, No. 151 (LC/L.2219-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), December 2004; O. Cetrángolo and J.P. Jiménez, "Política fiscal en Argentina durante el régimen de convertibilidad", *Gestión pública series*, No. 35 (LC/L.1900-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2003. United Nations publication, Sales No. S.03.II.G.60.

The budgetary pressures mentioned above are compounded by increasing demands for fiscal funding arising from the need to extend pension coverage through non-contributory means.

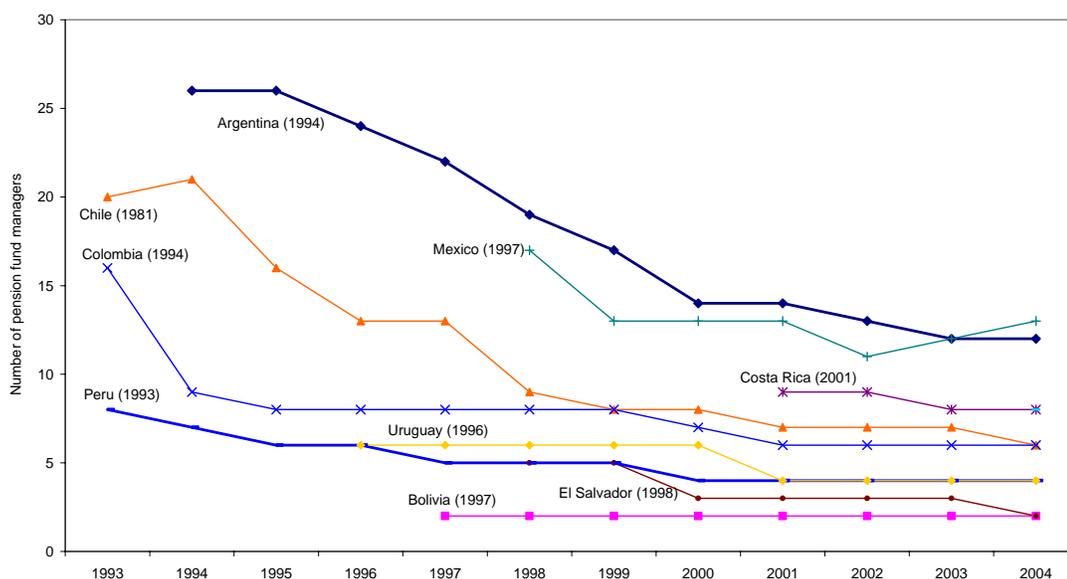
### Efficiency and costs

Incorporation of the private sector through competitive fund-management firms should, in principle, produce profitable and secure management of savings funds and a gradual decrease in management costs. Nonetheless, competition between fund managers in Latin America has not focused on the most relevant variables (price and risk-adjusted returns); market concentration has increased; and efficiency gains have not been passed on to users.

The absence of real competition in terms of prices and returns is due to the nature of supply and demand for pension-fund management services. On the supply side, studies show that the cost structure is subject to significant economies of scale, owing to the presence of substantial operating overheads (Mastrángelo, 1999). Second, it has been found that individual demand is highly inelastic with respect to the commissions charged or the relative performance of fund managers in terms of return (Berstein and Ruiz, 2005). This has been blamed on the compulsory nature of the retirement-fund management service, difficulty in comparing the services provided by the different fund managers, lack of knowledge or understanding of how the system operates and the population's limited financial culture. It has been noted that, in most cases, a decision to switch pension fund administrators—which ought to be the main element of market discipline—usually follows visits by sales personnel or promoters offering rewards or gifts.

The combination of economies of scale in service provision and a demand that is highly price and returns inelastic has led to a gradual concentration of this activity in all countries that have introduced this type of reform (see figure IV.6).

Figure IV.6  
**CONCENTRATION OF PENSION FUND MANAGERS**  
(Number of fund managers in existence each year)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Lastly, the clearest evidence that this activity lacks the conditions needed for efficient competition are the profits earned by fund managers. A recent study by Valdés and Marinovic (2005) estimated that between 1999 and 2003 Chilean pension fund managers recorded an average

pre-tax rate of return on assets of 53% per year, with an average level of exceptional profits of around 0.10% of GDP. No new operators entered the market in the country during this period.

The search for higher profits may encourage lower production costs and the exploitation of economies of scale, but in the presence of a certain degree of market power and entry barriers, efficiency improvements do not necessarily translate into lower commissions or better pensions for system affiliates.

## Reform agenda

Countries in the region are facing the twin challenge of extending pension coverage to all of their older adult population while guaranteeing the financial sustainability of the entire system in the short and long terms.

Given the low saving capacity of large segments of the population and the fact that employment in the region has become increasingly informal and precarious over the last two decades, changes in coverage should aim first and foremost at developing and consolidating non-contributory pension schemes. These should be seen as essential elements in guaranteeing widespread access to decent pensions for population groups that have no contributory capacity, rather than as welfare-based tools with uncertain funding. In addition, solidarity models targeting lower-income contributors need to be strengthened; the contributory participation of workers with some saving capacity but who do not actually participate needs to be improved; and adequate integration between the contributory and non-contributory regimes needs to be guaranteed.

A number of factors specific to the region call for special care when introducing the changes needed to put pension systems on a financially sustainable path. First, it has been noted that problems in the design or management of PAYG systems tend to generate serious financing difficulties. Second, the population ageing process in Latin America and the Caribbean is expected to be particularly rapid during the next few decades, giving rise to a period in which pension demands will need to be financed by a relatively smaller working-age population.

The financial-sustainability challenge requires strengthening and unification of the contributory component of pension systems through a combination of reforms aimed at aligning contributions with pension payments, at the systemic or individual level, together with transparent solidarity mechanisms targeting lower-income contributors. In addition, as people exercise their right to live decently in their old age, and as a large proportion of their needs will be covered through non-contributory mechanisms, a fiscal responsibility is created to deal with the contingent liabilities generated by these entitlements in the short and long terms.

The emphasis of countries' policy programmes will depend, among other things, on the initial situation of their pension systems, their public fundability, the level of contingent pension liabilities and society's own preferences in terms of efficiency and solidarity. The following paragraphs propose elements for consideration in national debates on pension-system reforms in the region's countries.

## Coverage and solidarity

Any real expansion of pension coverage in the region necessarily involves, at least in the short and medium terms, the establishment or consolidation of non-contributory schemes that provide basic pensions to people who reach old age without the income or assets needed for their subsistence, irrespective of their record of contributions to the contributory regime. Such programmes should be understood as an essential part of an integrated social protection system.

Moreover, efforts to achieve equitable coverage across the board must aim to establish solidarity-based mechanisms targeting lower-income contributors and to encourage contributory participation by workers with some saving capacity while ensuring adequate interaction between the contributory and non-contributory pension models.

### Strengthening the non-contributory component

In a context of inequality and scarcity of resources for social investment in the countries of the region, the easiest way to ensure a decent standard of living for all people during their old age is to provide targeted pensions for all older adults living in poverty. Although universal pension schemes have the virtue of simplicity in terms of means testing, they are more difficult to use because of the high financial and political cost of drawing on scarce public resources to provide benefits to segments of the population that have sufficient means of their own to live a comfortable old age. This partly explains the lack of dissemination of this type of programme at the international level.<sup>31</sup>

Box IV.8 illustrates the hypothetical exercise of delivering pensions to all of the region's over-65s who are living in poverty. A benefit of this type (equivalent to each country's poverty line) would on average make it possible to halve the poverty rate among older people at a cost equivalent to 0.93% of GDP in each country.<sup>32</sup> A universal pension would have this same effect on poverty, but at an average cost equivalent to 2.2% of GDP in each case.

Pension targeting, while making it possible to release a significant portion of scarce public resources, is not free from operational and administrative problems. The targeting mechanism depends on the level of development of the systems used to identify potential recipients and the feasibility of detecting alternative income sources, such as other pensions, formal employment, income from financial assets or real estate, among others.

Whatever the method chosen, any form of means-tested targeting can create disincentives for forms of saving and formal employment, although, as shown later in this section, these effects can be mitigated by making contributory and non-contributory pensions compatible through a gradual reduction in benefits from a defined cut-off point. In addition, the targeting criteria must correspond to direct or indirect measures of unmet basic needs, but should not be directly related to an individual's contribution history, since this could create strong incentives for self-exclusion from contributory social protection.

National specifics aside, the simulation presented in box IV.8 shows that public expenditure targeting older adults living in poverty can be highly cost-effective. The costs of financing it represent an accessible percentage of national output in many cases, provided that reforms designed to make contributory pension regimes financially viable allow the relevant fiscal efforts to be concentrated on preventing poverty in old age.

### Contributory solidarity

In general, a correlation exists between contribution level and contribution density, such that workers who receive low wages tend to maintain a lower frequency of contributions, which translates into even lower pensions. Furthermore, this type of worker is usually more vulnerable to economic instability, so solidarity mechanisms are needed to help improve the quality of pensions among workers who earn relatively lower wages. This is particularly important since reforms that promote the financial

<sup>31</sup> Apart from New Zealand, the following five countries also have universal pension systems: Mauritius (1958), Namibia (1990), Botswana (1996), Bolivia (1996) and Nepal (1995) (Willmore, 2005). In the regional context, it would also be appropriate to mention the reform announced by the incoming Government of Antigua and Barbuda, and the initiative of the current government of Mexico City.

<sup>32</sup> Despite delivering hypothetical benefits equivalent to the poverty line, this does not eliminate poverty among older adults, because many of them live in multigenerational households. While the benefit covers the basic needs of the individual, it does not necessarily enable the household to escape from poverty (Rodríguez Vignoli, 2005b).

sustainability of contributory models by developing a closer alignment between contributions and benefits also tend to undermine the inherent solidarity of traditional PAYG schemes.

#### Box IV.8

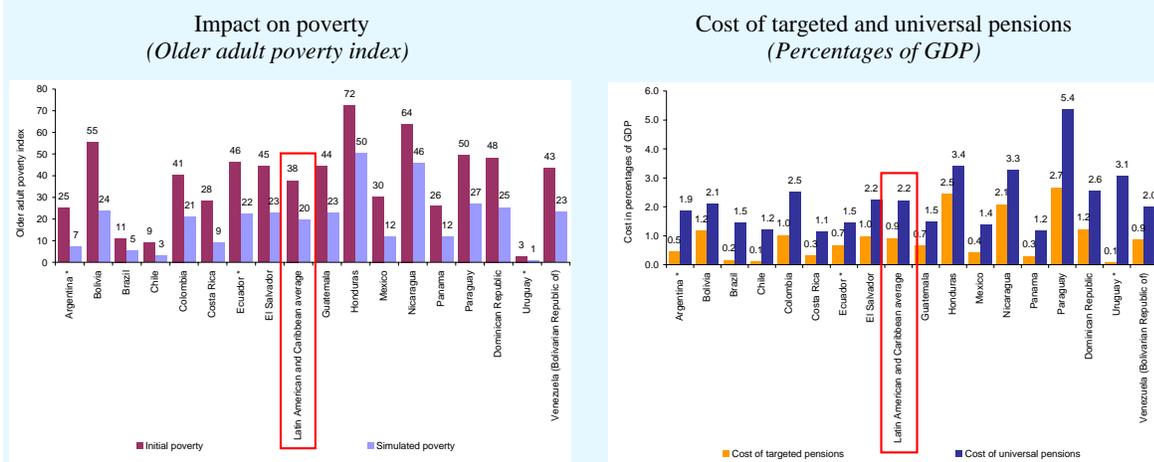
### LATIN AMERICA AND THE CARIBBEAN: THE COST OF GRANTING NON-CONTRIBUTORY PENSIONS AND THE EFFECT ON POVERTY

Non-contributory pension schemes can have significant effects on reducing poverty in old age, and at reasonable fiscal costs for most countries.

The following figures show the result of a simulation of the effect of granting non-contributory pensions to the population of over 65 years of age, based on household surveys in 17 of the region's countries. The exercise envisages two possibilities: first, granting a universal benefit equivalent to the poverty line in each country (or region of each country); and second, granting a benefit targeting older adults living in poverty.

The first figure shows the incidence of poverty in the case of the over-65s, before and after the transfer (the effect on the poverty index is the same in both types of programme by definition). The second figure compares costs between the two alternatives (targeted or universal pension).<sup>a</sup>

#### LATIN AMERICA: COST OF GRANTING TARGETED AND UNIVERSAL PENSIONS AND THE IMPACT ON POVERTY



\* Urban surveys.

Both programmes reduce poverty among older adults by an average of 18 percentage points, albeit with significant variations between countries. The average cost of the targeted pension is 0.93% of GDP, while the universal pension requires resources averaging around 2.2% of each country's GDP.

Average cost-effectiveness of the targeted pension is 0.05; i.e., an expenditure of 0.05% of GDP is needed to reduce poverty in old age by one percentage point. Nonetheless, poverty reduction is considerably more expensive in some relatively lower-income countries (around 0.11% of GDP for each percentage point of poverty in Honduras, Nicaragua and Paraguay). This indicates the highly precarious position of older adults in these countries, where much larger transfers are required to lift them out of their marginality.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys applied in 2002, except in Paraguay (2000), Brazil, Nicaragua and El Salvador (2001), and Chile (2003).

<sup>a</sup> Direct cost of benefits delivered. The exercise does not include the potential for universal pensions to be recovered *ex post* through taxes, the saving in terms of administrative targeting systems, or the potential disincentive effect of the latter.

Various types of solidarity mechanisms can be applied to contributory models based on individually capitalized accounts. Those containing a guaranteed minimum pension (a feature of most substitutive reforms) make it possible to guarantee a minimum level for self-financed pensions, but these are generally limited to individuals who have made a significant number of

contributions (typically 20 years).<sup>33</sup> Something similar occurs in the case of the basic universal benefit in Argentina, which is supplementary to contributory pensions although limited to workers with at least 30 years' contributions. More attractive, from the standpoint of progressiveness, are the alternatives chosen in Colombia (the Pension Solidarity Fund) and Mexico (the Social Quota), since they subsidize contributions made by lower-income contributors (in the case of Columbia) or all contributors (in the case of Mexico). From a gender perspective, the same life tables could be used for both sexes when calculating life annuities.

Models based on a PAYG system lend themselves more easily to the incorporation of progressive solidarity and gender mechanisms. The Costa Rican reform of 2005 is the most recent case to have introduced explicit criteria for redistribution towards lower-income affiliates and women (see box IV.9). In terms of gender solidarity models, the Canada Pensions Plan allows for years spent raising children under seven to be excluded from the calculation of reference income (Velloso and Vézina, 2005).

Box IV.9  
**THE COSTA RICAN REFORM OF THE DISABILITY, OLD-AGE AND SURVIVOR  
PENSION REGIME (2005)**

Following a lengthy process of public debate among the various stakeholders in Costa Rican society, the disability, old-age and survivor pension regime, which is managed by the Costa Rican Social Security Fund, was reformed in 2005. This was the system's first reform since its establishment in the 1940s.

The retirement age of 65 was left unchanged, but contribution requirements were increased from 20 to 25 years. A gradual increase in contributions was also introduced, rising from 7.5% to 10.5% over a 30-year period (an increase of 0.5% every five years as from 2010). The reference wage for calculating pensions was changed from the best 48 nominal wages of the last 60 months (five years) to the average of the last 240 wages (in real terms) on which contributions were paid (20 years). The aim here was to reduce incentives for under-declaration and correct certain inequities. In fact, lower-income individuals tend to receive lower wages close to the end of their working life, which means that their pension would be calculated on the basis of a lower contribution than their lifetime average; in contrast, high-income individuals have a better chance of manipulating the wages they declare at the end of their working life and, thus obtain higher pensions than they otherwise would. In addition, a new formula was created for calculating pensions that are differentiated by income level, which lowered the replacement rate for higher-income individuals but kept it unchanged for those with lower incomes.

A lower old-age benefit was also established for individuals who reach retirement age with more than 15 but less than 25 years' worth of contributions. This consists of an additional percentage point on the minimum pension, rising with the number of years of contribution. A new early retirement alternative was also introduced, making it possible for individuals under 65 years of age to retire having fulfilled the requirement of 25 years' contributions, in exchange for a reduction in the size of the pension, provided this is above the minimum.

The positive treatment afforded to women wishing to retire early should be highlighted. The percentage reduction for this purpose is less than that envisaged for men, and it is calculated so that the advance is actuarially neutral for the system. This early retirement possibility is in addition to the existing alternative of retirement at 60 (women) or 62 (men), provided contributions have been made for more than the minimum number of years.

**Source:** Rodríguez, "La reforma costarricense al Régimen de Invalidez, Vejez y Muerte", San José, 2005, unpublished.

### Incentives for participation in contributory regimes

Although efforts to encourage contribution have not resolved the problem of pension coverage at the aggregate level, an adequate structure of incentives could have positive effects on contribution behaviour in certain segments of the population and also reduce problems of under-reporting.

Although, in theory, the new defined-contribution systems that have been adopted in several of the region's countries should improve incentives to participate in formal pension schemes, it has been shown that a closer correlation between contributions and benefits is insufficient to achieve

<sup>33</sup> The reforms currently being debated in Chile include a proposal to graduate the minimum pension guaranteed by the State, so that an individual who has made fewer contributions than the minimum required (20 years) has access to a minimal pension, albeit below the current minimum. Fajnzylber (2005a) analyses and simulates the cost of this alternative for Chile, compared to a universal pension and a targeted pension.

this objective. There are two reasons for this. First, lower-income workers tend to engage in informal activities, which makes contribution difficult, given the effect this would have on other taxation obligations arising from the activity.<sup>34</sup> Second, equivalence between contributions and benefits is fundamentally a long-term incentive which, given the level of per capita income in the region, is hard to reconcile with the short-term consumption needs of a large part of the population that is in a position to contribute.<sup>35</sup> With a view to tackling this problem, several initiatives have been proposed in the region to encourage participation by linking contribution to specific short-term benefits, such as fast-track access to housing, preferential health services and loans (see table IV.5).

Table IV.5  
PROPOSALS TO ENCOURAGE CONTRIBUTION

| Proposal                               | Description   | Comments   |
|--|---|--|
| Tax benefits                           | Create or extend tax benefits for self-employed workers   | Tax benefits are only relevant for higher-income workers   |
| Rewards for participation              | Provide rewards in cash or kind for constancy in contributions by low-income workers. Could be managed through the tax system                 | Allows for better targeting than tax incentives. Application depends on the coverage of tax systems. High potential cost   |
| Graduated minimum pensions             | Extend the logic of minimum pensions, guaranteeing a lower limit that rises with the number of years of contribution                          | Makes it possible to guarantee a degree of quality to pensions and protect from low levels of profitability, late or small contributions, and actuarial differences based on gender    |
| State contributions                    | Enable the State to contribute to individual accounts, to the extent that the worker also contributes   | Not very effective if workers assign a low value to benefits in the distant future. Regressive stimulus favouring more stable workers  |
| Allow loans                            | Allow the worker to take out a loan for a limited amount, secured by future benefits in the case of non-payment (e.g. delayed retirement)     | Initially attractive for low-income workers who place a high value on the liquidity of their saving sources. Nonetheless, uncertain incentive effect after the first unpaid instalment |
| Housing accounts                       | Divert part of the contributions to special accounts that can be optionally used to finance housing. If unused they become pension assets     | Very attractive, although important to avoid erosion of pension funds through restrictions that undermine the liquidity of homes acquired this way                                     |
| Points for subsidized housing          | In countries with points-based housing subsidy programmes, establish that frequent contribution is reflected in higher points for the subsidy | Attractive for lower-income workers. It avoids loopholes, since only the most needy gain access to this type of subsidy  |
| Disability insurance                   | Extend or facilitate coverage of disability insurance to self-employed workers who make contributions with a certain annual frequency         | The incentive effect depends on the value assigned to this service by workers and lends itself to opportunistic behaviour or moral hazard  |
| Reduce transaction costs               | Facilitate quarterly or annual contributions by self-employed workers. Allow contributions through the tax system                             | Of greater effect among workers in the middle- and high-income strata, whose incomes are highly variable   |
| Preferential access to health services | Link payments into contributory social security schemes (in terms of health and pensions) to access to preferential health services           | As in the case of housing, health care is a highly attractive service, which can attract informal workers into contributory schemes  |

**Source:** R. Paredes and A. Iglesias, "Análisis de propuestas para aumentar la cobertura de trabajadores independientes en el sistema de AFP", document presented at the seminar "Competencia y cobertura", Santiago, Chile, Centro de Estudios Públicos (CEP) and Superintendencia de Administradoras de Fondos de Pensiones, 11-12 November 2004; E. Fajnzylber, "Pensiones para todos: análisis de alternativas para extender la cobertura del sistema chileno de previsión social", working paper, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC)/División Estudios de Superintendencia de AFPs, 2005, unpublished; H. Beyer and S. Valdés-Prieto, "Propuestas para aumentar la densidad de cotizaciones", document presented at the seminar "Competencia y cobertura", Santiago, Chile, Centro de Estudios Públicos (CEP) and Superintendencia de Administradoras de Fondos de Pensiones, 11-12 November 2004.

<sup>34</sup> Hence the importance of models that facilitate formalization among small productive units (see chapter II and ECLAC 2004b).

<sup>35</sup> Viewed from an economic standpoint, the current needs of lower-income sectors imply a very high discount rate, which substantially lowers the current valuation of future income streams to be obtained from pensions.

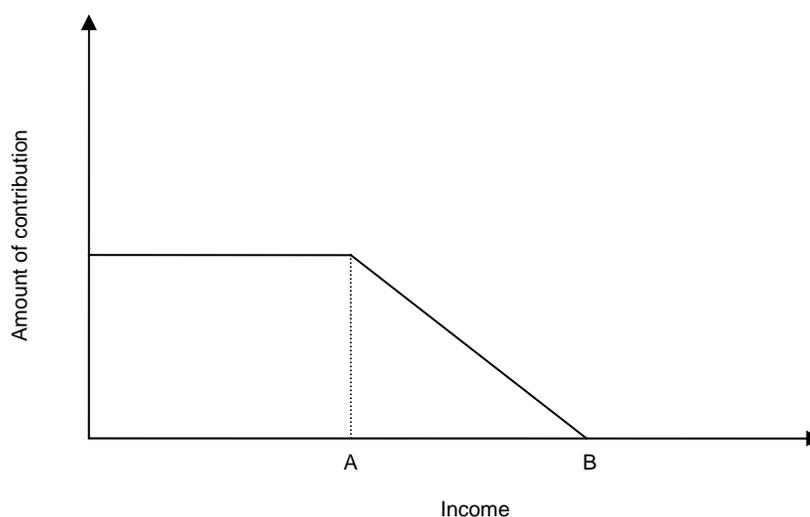
Although only a few evaluations and empirical results are currently available on the cost effectiveness of the different incentive proposals, it is important to stress that public expenditure in subsidizing contributory participation should be limited and can only be justified insofar as it makes it possible to introduce sectors with little or no saving capacity into the contributory system, thereby reducing their propensity to require non-contributory pensions to finance their old age in the future.

### Integration of contributory and non-contributory components

As contributory and non-contributory components become integrated, it is essential to ensure that the rules of compatibility between the two types of pensions and mechanisms for targeting non-contributory pensions do not create perverse incentives for exclusion from formal contributory coverage. For that purpose the design of the pension system needs to include the following elements: (i) non-contributory pensions must be compatible with contributory pensions, i.e. a person must be able to receive benefits simultaneously from both regimes,<sup>36</sup> and (ii) targeting should be gradual—a basic level of benefits should be established, but this should be reduced as from a certain cut-off threshold, based on the applicants' level of unmet basic needs. The option of setting an absolute poverty threshold that distinguishes beneficiaries from non-beneficiaries can create strong disincentives to saving or formal employment, while also facilitating corruption or arbitrary decision-making by persons responsible for assessing needs. As figure IV.7 shows, non-contributory benefits should start to diminish gradually as from a certain income threshold (A), until they disappear after income level (B), beyond which it is considered that non-contributory subsidies should not exist.

Figure IV.7

#### GRADUAL TARGETING OF NON-CONTRIBUTORY PENSIONS



The Swedish reform of the early 1990s is a good example of integration between the different components. This included two contributory components (a notional accounts model and another fully funded model based on individually capitalized accounts), supplemented by a lower limit funded out of general tax revenue, and a gradual scheme to reduce non-contributory benefits (see box IV.10).

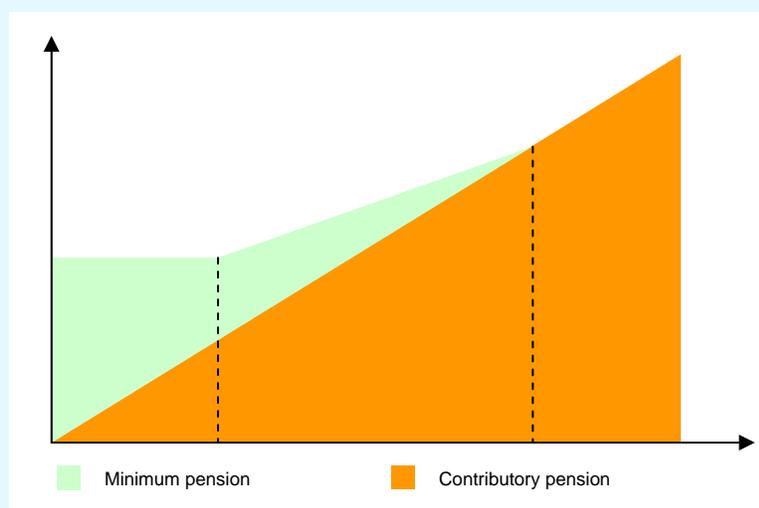
<sup>36</sup> Contributory pensions can indirectly affect eligibility or the amount of the targeted pension, but only as one of the potential sources of income in old age. The important point is that the entitlement to a contributory pension should not automatically exclude access to a targeted pension.

## Box IV.10

**THE SWEDISH PENSION MODEL**

Since the 1950s Sweden has had a pension system consisting of a small universal pension together with a PAYG defined-benefit scheme. This was considered unfair by workers with relatively long (or flat) contribution histories, and projections showed that gradual population ageing would drive up contribution rates to levels that were unacceptable for future workers. During the 1980s, the perception of workers joining the system tended to be that it was incapable of fulfilling its future promises.

In the early 1990s, a deep economic recession, compounded by a shrinking of the system's contributor base, created the political consensus needed to initiate a reform process that culminated in 1994. The reforms replaced the existing model with a combination of two complementary defined-contribution systems: one, PAYG with individual notional accounts; and the other, fully funded with individually capitalized accounts. The floor of the system is provided by a guaranteed minimum benefit, financed out of general supplementary funds. To achieve appropriate interaction between the two schemes (the contributory and minimum pension) a mechanism was established for gradually reducing non-contributory benefits (see following figure).

**INTERACTION BETWEEN CONTRIBUTORY AND MINIMUM PENSIONS**

Unlike the structural reforms that have been implemented in the Latin American and Caribbean region, the individual full-funding component is managed by a public body, and the only activity that is delegated to the private sector is the investment of the contributions. Individuals notify this entity of their choice of fund manager, and the latter accumulates individual demands and orders fund transfers anonymously. The management firm therefore does not know the identity of the members whose savings it manages.

The main guidelines of the reform were as follows: (i) "fair" treatment for people with different contribution histories. Two individuals that have contributed the same amount and retire at the same time and same age should receive similar benefits. This means that pensions are exclusively related to the amount contributed, and not the number of years of contribution, a certain number of better years, or years of service, which are common features in European PAYG systems; (ii) a transparent redistribution mechanism. The new system provides this through the minimum guaranteed pension, which is financed out of general funds specifically budgeted for this purpose; (iii) the financial stability of the system in relation to demographic and economic changes. The old system assumed that future workers would pay the cost of the pensions of retirees, whatever their amount. With the new system, the aggregate long-term contribution rate should be the same as that paid by current workers; and (iv) the creation of a scheme of financial saving managed by private institutions. These savings will play the role of reserve funds of the current PAYG system, which will tend to disappear as the large cohorts of the 1940s retire.

**Source:** Edward Palmer, "Sweden's new FDC pension system", paper presented at the seminar "Competencia y cobertura", Santiago, Chile, Centro de Estudios Públicos (CEP) and Superintendencia de Administradoras de Fondos de Pensiones, 11-12 November 2004; and "The Swedish pension reform model: framework and issues", *World Bank Social Protection Discussion Paper*, No. 0012, Washington, D.C., World Bank, 2002.

## Financial viability

Most countries in the region are currently finding it hard to meet the financial requirements of their population's pension needs. As this is compounded by future demands arising from the ageing process, full financial sustainability of pension systems is a fundamental element of any reform process. Given that the region's pension systems should include both contributory and non-contributory components, the financial viability of the process depends both on fiscal performance and on actuarial trends in contributory systems.

In the contributory domain, as argued above, although the introduction of funded schemes in individually capitalized accounts tends to improve the long-term actuarial situation of pension systems, it entails transition costs that can seriously undermine the financial viability of the reforms. To reduce these costs, reform processes must gradually evolve towards contributory systems that combine a unified and reformed PAYG component with an individual capitalization component.

This not only limits transition costs, but also makes it easier to diversify economic risks, since the financial viability of the PAYG system depends largely on variations in the real sector of economy, whereas the funded system responds more to variations in the financial domain.<sup>37</sup> This combination also makes it easier to diversify demographic risks in the face of changes in dependency ratios.

An additional pressure on the financial requirements of pension systems is the existence of special regimes that use significant amounts of resources but benefit small fractions of the population. For that reason the unification of pension systems, beyond its equity effects, is positive from a long-term financial perspective.

Expanding the coverage of benefits from non-contributory pension models imposes significant financial burdens on the public sector. To the extent that benefits offered by these models become acquired rights, they also become contingent liabilities for the State, which need to be financed independently from the vagaries of the business cycle.

An important issue concerns the calculation of contingent liabilities and how they evolve over time. These are affected by three factors: first, the amount and volume of the benefits guaranteed; second, the existence of significant changes in populations with and without contribution capacity over the business cycle; and third, the way in which solidarity is financed. Insofar as workers' and employers' contributions do not contribute to its financing, the cost to the Treasury will tend to increase.

## Summary

Reforms to pension systems should aim to expand coverage of the non-contributory component and improve the solidarity of the contributory component through a model that integrates both schemes, maintains incentives for contribution, and guarantees short- and long-term financial sustainability. The combination of a PAYG component (with clear rules for changing the parameters), a funded scheme (competitive and low-cost), a guaranteed non-contributory pillar for older adults living in poverty, and solidarity rules for contributors with inadequate pensions (financed out of general tax revenue or through contributory solidarity) would seem to comprise a satisfactory arrangement.

The integration of these three components, which makes it possible to introduce contributory and non-contributory solidarity mechanisms and maintain the link between contributions and benefits, is a significant incentive for contribution. Regardless of the institutional format in which these components are integrated, a move towards unification of the pension system is needed, because, as mentioned above, the existence of multiple systems generates inequities and inefficiencies.

<sup>37</sup> Naturally, the magnitude of some of the economic crises that the region has endured affect both components simultaneously.

An essential element to take into account in the reform agenda is the starting point (i.e. the current characteristics of pension systems). Countries that have opted for substitutive reforms and have overcome a large part of the cost of transition to individually funded models should focus their reform efforts on strengthening solidarity and reducing costs. Countries that have applied mixed or parallel models should consolidate the PAYG components and integrate them with funded models on a complementary basis. Countries that maintain exclusively PAYG systems need to consider introducing a supplementary individual account component, alongside the necessary parametric reforms, while taking care to spread the transition costs.

Parametric reforms can either be made in the context of notional systems or else be targeted on specific parameters. It is also important to minimize the transition costs that can arise from the incorporation of an individually funded component. In some initiatives such costs have been addressed by raising the contribution rate and channelling the surplus into the fully funded component.

Irrespective of how the contributory components are organized, all countries face the challenge of strengthening their non-contributory subsystem and solidarity mechanisms.

## Glossary

**Defined benefit and defined contribution:** A contributory pension system is classified as a defined-benefit system when its benefits are calculated on the basis of a fixed replacement rate for all individuals who satisfy certain requirements. In a defined-contribution system, the parameter held constant is the contribution rate; but there are no explicit commitments as to the replacement rate of pensions eventually paid.

**Contribution density:** Average frequency of contributions paid into a contributory pension system (e.g. number of months between 15 and 64 years of age in which an individual makes contributions, as a percentage of the total number of months in that period).

**Non-contributory pensions:** Monetary benefits that do not require contributions to have been made to a pension system.

**Structural pension reforms:** Modification of contributory pension systems, whereby the PAYG system is totally or partially replaced by a fully funded system comprising individually capitalized accounts.

**Parametric pension reforms:** Alteration of certain parameters of PAYG systems, such as replacement rate, retirement age, contribution rate, requirements for gaining access to benefits, or their indexation rules.

**Fully funded system:** Contributory pension system based on individual savings accounts. The funds contributed by a worker are invested in financial instruments. The pension paid depends actuarially on the balance in the individual account and life expectancy at retirement.

**Notional accounts system:** PAYG system in which there are individual accounts for each worker, and the benefits are paid on the basis of the sum total of indexed contributions and life expectancy at retirement (see box IV.5).

**PAYG system:** Contributory pension system in which the funds contributed by active workers are used to finance the pensions paid to retirees from this system. If pensions paid are less than the amounts received, the system is partially funded. In the opposite case where pensions are higher or equal to contributions, the system is pure PAYG.

**Contribution rate:** Percentage of an individual's labour income that is paid into a contributory pension system.

**Replacement rate:** Ratio between the pension paid to an individual and income received during his or her working life.



## Chapter V

# Social programmes

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## Introduction

In order to make the full and effective enjoyment of economic and social rights a reality, public programmes are needed to promote social integration and inclusion. This chapter reviews the most recent initiatives in the region relating to social programmes aimed at reducing poverty in its many dimensions, both by mitigating its most immediate effects and through capacity-building.

The linkage between the short-term effects of increased household incomes and the long-term effects of human capital development among the region's most disadvantaged children and young people are the key to progress in overcoming poverty through social policies and programmes. Such programmes therefore need to combine policies that support human and social capital formation (capacity-building), policies that expand access to good quality jobs (expansion of opportunities) and short-term assistance policies aimed at protecting vulnerable population groups from the temporary or structural adversities that are arising with increasing frequency in the current economic context of the region.

Social programmes in Latin America and the Caribbean have a long history of multidimensional interventions designed to strengthen human capital, with the ultimate goal of offering productive opportunities and improving the family and community environment. The past few years have seen the emergence of a new generation of initiatives known as "conditional transfer programmes". These initiatives use monetary transfers and conditioning rules as vehicles for generating synergies between different dimensions of human capital, and between these and the short-term alleviation of poverty.

Many of the region's poverty reduction programmes have arisen in response to the vagaries of the business cycle and economic crises. Because the negative effects of such (including increased structural unemployment and persistent poverty) crises have been so long-lasting, however, these programmes are gradually coming to be permanent fixtures of social policy.

This chapter analyses recent social programmes in the Latin American and Caribbean countries, highlighting those which have had the broadest coverage and have been most widespread in the region: employment-related emergency programmes and conditional transfer programmes. In addition to describing the general characteristics of such programmes, the chapter presents the main conclusions of the evaluations that have been conducted.

The undeniable achievements of these programmes notwithstanding, a number of tasks remain. In the case of employment-related emergency programmes, for example, worker training components need to be strengthened in order to avoid the loss of human capital that occurs in periods of recession. In relation to conditional transfer programmes, the chapter looks at how to reconcile effective entitlement to rights with the obligations that arise from conditionality; how to strengthen the empowerment of beneficiaries (particularly women) and the importance of incorporating social capital considerations. Lastly, the chapter draws attention to the need to reconcile the demand for services generated by these programmes with effective, high-quality delivery.

## From the multidimensional nature of poverty to programmatic diversity

### The complexity of poverty

Recent analyses have highlighted the link between poverty, understood as the lack of sufficient resources to satisfy a set of basic needs, and other shortcomings that either cause poverty or accompany it, such as a lack of skills or assets, insufficient participation in society, powerlessness, restricted access to social and symbolic capital, and other social, cultural and political problems. Living in poverty does not simply mean being unable to afford the goods and services which are essential to meet basic needs; being poor also entails social exclusion, which prevents full participation in society and undermines the enforceability of rights. Thus, poverty is multidimensional in terms of its causes, consequences and manifestations (ECLAC, 2003a).

Poverty prevents people from fully sharing in the benefits of development, that is, the enjoyment of a standard and quality of life that a society should be able to guarantee for its members based on its average levels of progress and welfare. In this sense, it entails diminished citizenship, since poor people are deprived of the benefits and mechanisms of belonging, to which they should be entitled as members of society. In other words, poverty hinders people's ability to exercise the individual right to a decent life, which requires being able to satisfy the basic needs of life.

If both poverty and the inability to exercise rights are associated with insufficient access to productive resources and scant participation in social and political institutions, then demands for effective citizenship are also demands for the resources needed to overcome poverty. Once the enforceability of such rights has been recognized, the provision of the necessary resources, both material and symbolic, becomes the responsibility of the State and society at large, and thus constitutes a key area of public policy. Social programmes and policies should then be seen as mechanisms of social integration and inclusion that facilitate the exercise of full citizenship.<sup>1</sup>

The fact that large segments of the population continue to live in poverty or indigence has led to a recognition in the region of the difficulties involved in finding rapid solutions and the need to

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<sup>1</sup> In view of the glaring inequalities prevailing in the region in this field, programmes need to target different income strata. Nonetheless, given the priority aim of eradicating poverty and addressing employment problems, over the last few decades pride of place has been given to programmes targeted on the poorest groups and on employment plans.

understand the complexity of poverty's various manifestations (see box V.1). Escaping from poverty is not easy, and it is not something that happens once and for all. This is due not only to economic volatility, but also to human capital deficiencies and the factors that hinder the creation of stable high-quality jobs. As a result of these conditions, while certain government actions may produce short-term results, they do not always equip families with the actual tools they need to escape from poverty over the long term.

### Box V.1

#### DIMENSIONS OF POVERTY IN THE REGION

Poverty reduction programmes in Latin America and the Caribbean are being implemented in a context of high levels of marginality and extreme poverty. It is estimated that 40.6% of the population of Latin America (213 million people) were living in poverty in 2005, while 16.8% (88 million) were not merely poor but were living in extreme poverty or indigence. Although the overall proportion of the population living in poverty has been slowly declining, the contemporary demographic dynamic is such that the absolute number of poor people today is larger than in 1990.

High poverty indices are not only reflected in insufficient capacity to generate income, but are also associated with low levels of education and unhealthy housing conditions. The latest edition of *Social Panorama of Latin America* (ECLAC, 2005a) reports that while levels of non-attendance at school by children between 7 and 12 years of age are low in most countries, there are still large segments of the adult population that do not have a minimum of five years' schooling (over 20% have less than this minimum level in 10 of the 17 countries analysed).

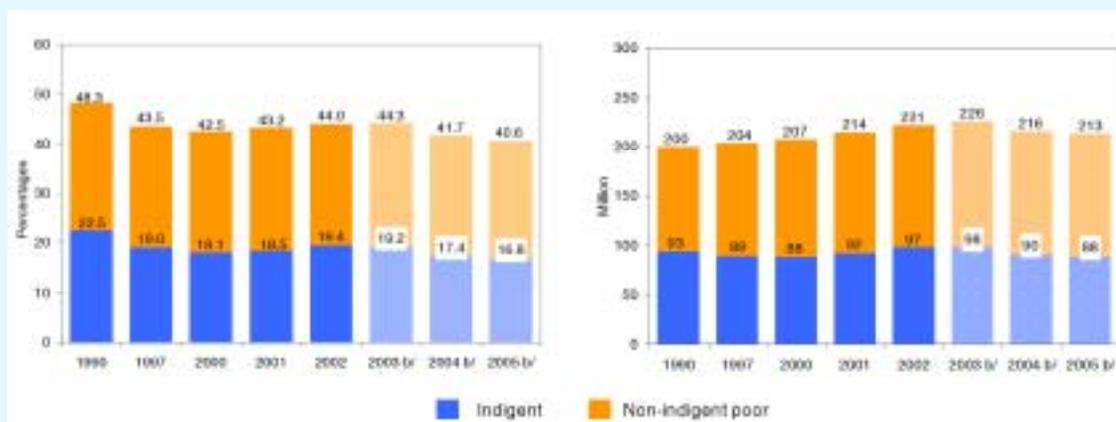
The situation is particularly critical in view of the high indices of crowding and inadequate systems of sewage disposal in the homes of large proportions of the region's population. The problem of too many people living together in a single home affects over 30% of the population in 9 out of 14 countries analysed. A similar percentage of the population has no connection to public sewerage systems in urban areas or to a septic tank in rural areas in 13 out of 17 countries for which information is available.

These factors affect the living standards of families in the region and influence the capacity of future generations to escape from poverty in its different dimensions, given the lack of facilities available to them to obtain full and constructive schooling.

#### LATIN AMERICA: TREND OF POVERTY AND INDIGENCE, 1990-2005<sup>a</sup>

Poverty and indigence rates

Number of poor and indigent people



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America, 2005. Briefing Paper*, Santiago, Chile, 2005.

<sup>a</sup> Estimate for 18 of the countries of the region, plus Haiti. The numbers superimposed on the orange-coloured sections of the bars represent the percentage and total number of poor people (indigent plus non-indigent poor).

<sup>b</sup> Projections.

Accordingly, programmes need to combine short-term poverty relief measures with others aimed at eliminating its more structural causes. The latter are reflected in the intertemporal dimension of poverty since, in addition to having low levels of income, poor families accumulate insufficient human capital in terms of nutrition, health and education, among other things, which diminishes young people's chances for the future and militates against access to equal opportunities. Other factors that systematically fuel the intergenerational reproduction of poverty are of an ascriptive nature. In particular, it has been noted that being a woman, belonging to an ethnic minority and living in rural areas are clear social disadvantages that reduce the chances of having an adequate level of income and opportunity. Moreover, exposure to recurrent adversities, such as cyclical macroeconomic crises and natural disasters, tends to have a disproportionate effect on the poorest groups, who have few assets and resources with which to defend themselves from negative disturbances or to restore their economic situation in the recovery phase (Cruces, 2005).

Poverty can therefore be described as a multidimensional phenomenon that influences many different aspects of life which are virtually impossible to encompass in a single definition. Nonetheless, it is important to distinguish the characteristics of poverty itself from other related factors which may be causes, consequences or simultaneous phenomena. The first point of reference is the inability to satisfy basic survival needs, which undoubtedly constitutes the "irreducible core" of poverty (Sen, 1984). A minimum supply of food and shelter from the elements are basic needs, and a failure to meet those needs signifies poverty in any contemporary society.

Attempts have recently been made to include non-material and symbolic dimensions in the concept of poverty. For example, special attention is often paid to the social capital that is made available to members of the community through their participation in social exchange networks that provide them with knowledge, information, organizational ability and even political power. It is argued that people who lack human, physical and monetary capital tend to perpetuate the conditions of material poverty, whereas access to symbolic goods and the strengthening of social capital serve as effective levers to help people break free from the vicious circle of poverty and its intergenerational transmission. For over a decade now, ECLAC has been warning of the need to universalize access to the codes of modernity. These codes involve the possession of certain skills (such as reading and writing, calculation, analytical capacity, information processing, along with communicative and management abilities) that enable people to participate more equally in the cultural affairs of society and help them to adapt to new forms of work and production. Recently, ECLAC has drawn attention to the importance of belonging to interactive networks and engaging in distance communication, which are viewed as symbolic capital that affects citizen participation, cultural exchange, the management of resources and assets, public visibility and labour productivity.

Viewed from another perspective, the concept of human poverty popularized by the *Human Development Report* (UNDP, 1990), which was formulated under the influence of the "capacities" approach developed by Amartya Sen, has been characterized as "...the denial of opportunities and choices most basic to human development —to lead a long, healthy, creative life and to enjoy a decent standard of living, freedom, dignity, self-esteem and the respect of others" (UNDP, 1997). The notions of human development and human poverty highlight the importance of shaping a global view of these concepts while avoiding extreme simplifications such as those associated with their quantification on the basis of income. Nonetheless, the related indices have many empirical shortcomings. The inclusion of more quantifiable dimensions is hindered by the lack of comparable data at the global level and the need to delimit the scope of analysis to facilitate the interpretation of results. For these reasons, the dimensions of the human development index (HDI) and the human poverty index (HPI) are restricted to just three areas: longevity, knowledge and a decent standard of living.

In view of the above, it is impossible to avoid using traditional poverty indicators, for which reliable measurement instruments do exist. Be that as it may, the use of indicators should not be

considered as exclusive, but rather as complementary. Other variables that have been gaining in importance for analysis and policy design include poor people's own perception of their situation and their efforts to improve their standard of living. This entails a change in relations between poor and non-poor sectors, since it means that support programmes will need to include an element of recognition and trust, which in turn helps to promote social networks among the poor and build bridges between them and other groups.

### **Policy criteria for dealing with the multidimensional nature of poverty**

The multidimensionality of poverty, which is both a process and a relationship, has implications for policies used to combat it. In general terms, ECLAC has argued that overcoming poverty requires action to be taken on the socio-economic factors that determine the chances of being or becoming poor as a result of the distribution and transmission of: (i) physical assets; (ii) educational capital and its influence in terms of differing employment opportunities; (iii) differences in social and symbolic capital; and (iv) types of family structure.

When poverty is analysed more as a process than as a state, the need becomes clear for public policies to act on the factors driving its reproduction, or the causes of its perpetuation from one generation to another, including education and training opportunities, geographic location, access to property and social and symbolic capital. Policies also need to tackle the consequences of poverty, measured by the loss of productive opportunities, of individual welfare, of social cohesion, access to goods and services markets and by the perpetuation of inequity. They also need to be geared towards changing the structural conditions that determine both the incidence of poverty and its manifestations, including macroeconomic stability, financial flows, productive heterogeneity, employment dynamics and distributive mechanisms.

This reveals the importance of diversified, flexible and appropriate policies applicable to the increasingly varied and changing conditions faced by poor people, which are the main factors that cause a segment of society to shift back and forth between a state of well-being and one of poverty or indigence.

Moreover, given the multidimensional and multicausal nature of poverty, while economic growth is essential for initiating and maintaining processes for eliminating this phenomenon, growth alone cannot overcome the range of structural factors that drive its intergenerational reproduction. This poses a major challenge both for productive policies and for social programmes and policies (ECLAC, 2004b). The latter need to merge long-term measures, including support for human and social capital formation to help families overcome the determinants of structural poverty, with short-term assistance to protect against transitory shocks (ECLAC, 2000b; Aedo, 2005).

A key aspect of human capital formation and accumulation is guaranteed universal access to high-quality education and health services. The effects of such access may even be seen in the next generation, when the current beneficiaries of better education enter the labour market with improved prospects. Social assistance programmes, including cash or in-kind transfer programmes for poor households, have more immediate effects since they allow large sections of the population to improve their well-being and raise their income and consumption levels, thereby helping them rise above indigence and poverty thresholds in the short term.

Sustained public effort is required for the proper execution of programmes that allow tangible targets to be achieved in the fields of education, health and nutrition. It is therefore essential to have a solid social institutional framework in place, capable of maintaining programmes' continuity and consistency over time and making sure that their long-term objectives are fulfilled, especially given the multiple short-term demands that governments in the region usually face.

During the 1980s and part of the 1990s, however, social programmes in most countries of the region were basically seen as compensatory policies targeting the poorest groups, and this prevented social policy from being restructured on an integrated basis.<sup>2</sup> In the second half of the 1990s, there was a change of direction; new, more multisectoral and community-oriented initiatives began to be taken to address the multiple causes and consequences of poverty.

Nonetheless, the generally tendency to turn targeted policies into permanent policy tools persisted, largely because the serious crises that affected the region severely constrained growth, investment and the creation of productive jobs. As mentioned in chapter I, although targeting involves concentrating social-policy efforts and public funds on areas where the redistributive effect is most progressive, prolonged targeting can also make beneficiaries more dependent and undermine the effective exercise of citizenship by inhibiting the development of people's capacity to integrate into society and participate actively in it.

In order to extend the effective ownership of rights to those least able to exercise them in a situation of resource scarcity, selectively favouring the lowest-income groups is a valid option. In this context, targeting has the dual effect of maximizing the impact of the resources used while benefiting those in the most precarious or vulnerable situations. This does not contradict the universal nature of social rights, since it aims to extend the exercise of a right to the people who are most deprived of it.<sup>3</sup> Lastly, as also noted in chapter I, the greatest risk of targeting (or selectivity not conceived as a tool for universalizing citizenship) is that it may result in the provision of services of uneven quality in important areas such as education and health, thereby reinforcing inequalities in terms of processes and effects between the poor and the remainder of the population, even if all people are offered the same access opportunities. The major challenge, therefore, is to create social programmes that facilitate access to suitable institutions that promote upward social mobility.

## The diversity of social programmes

The diversity of social programmes implemented in the region reflects the multidimensional nature of poverty, which is also seen in the wide range of objectives and areas of action contained in the programmes shown in table V.1.<sup>4</sup> The first type of programme listed, classified as “social benefits”, generally represents most of the efforts made by countries to alleviate the effects of poverty through monetary transfers, social housing and food programmes. In addition, special transfers to poor families, grouped under the category “management of social risks and vulnerability”, provide compensatory emergency assistance to the unprotected. In some cases, programmes respond to the specific needs and characteristics of particular population groups such as young people, the disabled and ethnic groups.

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<sup>2</sup> In the 1980s, priority was given to decentralization of services, policies, public management and decision making; expansion of private participation in the management and direct provision of services; targeting of programmes on the poorest population segments on the basis of social assistance or welfare policies; and rationalization of expenditure through new management, information and monitoring tools. In the 1990s, the previous decade's targeted welfare policies were improved, using new specialized tools to address different spheres of poverty through social funds (housing and environmental habitability conditions, utilities, roads and basic social infrastructure works, microcredit and productive equipment, among others). New services were also created targeting needy groups (women, children, older adults, the disabled, microentrepreneurs, campesinos and indigenous peoples). Nonetheless, as budget constraints made it necessary to target within these groups, programmes ultimately became pilot schemes that had some qualitative effects, but did not achieve universal coverage.

<sup>3</sup> Combating inequalities based on ascriptive categories requires institutional recourse to affirmative action in favour of those that are disadvantaged in terms of gender, ethnicity and disabilities —groups recognized as being on the fringes of social citizenship and having specific rights and benefits. This is because unequal exercise of social rights is corrected by measures to promote not only equal opportunities, but also equal paths. Selectiveness and affirmative action can be used not only to make starting opportunities fairer, but also to achieve less unequal outcomes.

<sup>4</sup> The programmes were selected to illustrate a variety of cases rather than on criteria of success, scope or representativeness. An exhaustive review of social programmes in the region is beyond the scope and aims of this chapter. For further information, see Repetto and Sanguinetti (2001) and Pardo (2003), in relation to Latin America; and Baker (1997) and CARIBANK (2005), in relation to the Caribbean.

Table V.1  
**CLASSIFICATION OF SOCIAL POVERTY REDUCTION PROGRAMMES, BY LINES OF ACTION**

| Category or type  | Description  | Areas of action   | Examples  |
|---|--|---|---|
| 1. Social benefits  | <ul style="list-style-type: none"> <li>- Ongoing social assistance policies</li> <li>- Objective: to cover income and consumption deficits associated with structural poverty</li> <li>- Long tradition in the region</li> </ul>                       | <ul style="list-style-type: none"> <li>- Unconditional direct income transfers</li> <li>- Conditional direct income transfers</li> <li>- Food transfers</li> <li>- Other transfers in kind</li> <li>- Price subsidies or reduced rates</li> <li>- Social housing programmes</li> </ul>                            | <ul style="list-style-type: none"> <li>- Conditional transfer programmes</li> <li>- School breakfast (Bolivia): food ration given to students attending the public school system</li> <li>- School bags, textbooks and classrooms (Ecuador): transfers in kind (non-food)</li> <li>- “Misión Mercal” (Bolivarian Republic of Venezuela): creation of establishments to sell food and other basic goods at subsidized prices</li> </ul>  |
| 2. Management of social risks and vulnerability                 | <ul style="list-style-type: none"> <li>- Objective: to strengthen the capacity of the most vulnerable groups to prevent or overcome the effects of adverse episodes</li> <li>- Time-limited</li> <li>- Concentration on palliative measures</li> </ul> | <ul style="list-style-type: none"> <li>- Unemployment benefits</li> <li>- Employment-related emergency programmes</li> <li>- Social protection in economic crises</li> <li>- Direct social assistance</li> <li>- Social assistance in emergencies (natural disasters and armed conflict, among others)</li> </ul> | <ul style="list-style-type: none"> <li>- Emergency programmes linked to employment</li> <li>- Social solidarity network and the Investment Fund for Peace (Colombia): humanitarian assistance to population groups displaced by internal violence</li> <li>- Assistance to families affected by Hurricane Mitch in Nicaragua</li> </ul>   |
| 3. Programmes targeting specific groups                         | <ul style="list-style-type: none"> <li>- Objective: to address the needs of groups considered vulnerable</li> <li>- Plurality in defining the intervention unit (vulnerable groups, individuals, families, households, communities)</li> </ul>         | <ul style="list-style-type: none"> <li>- Children (nutrition, child care, child labour)</li> <li>- Young people</li> <li>- Women heads of household</li> <li>- Groups with disabilities</li> <li>- Older adults</li> <li>- Ethnic groups</li> <li>- Depressed productive sectors</li> </ul>                       | <ul style="list-style-type: none"> <li>- Services for persons with disabilities (Brazil): labour-market and social integration of disabled people, cash transfers to the poorest</li> <li>- Crèche programme (Chile): children between three and 24 months old in situations of poverty, early development, nutrition and health check-ups</li> <li>- Comprehensive programme to support women heads of household, (Colombia): training and credit for low-income women in rural areas</li> <li>- Scholarships for students of indigenous origin (Chile)</li> </ul> |
| 4. Public programmes oriented towards production and employment | <ul style="list-style-type: none"> <li>- Objective: to promote social inclusion by strengthening the most disadvantaged households’ future capacity to generate autonomous incomes</li> <li>- Long-term poverty mitigation</li> </ul>                  | <ul style="list-style-type: none"> <li>- Employment preparedness and training</li> <li>- Productive projects</li> <li>- Access to credit and microcredit, and promotion of self-employment</li> </ul>   | <ul style="list-style-type: none"> <li>- Solidarity productive credit (Ecuador): aimed at women and disabled people who are beneficiaries of the Solidarity Bond; provision of credit, welfare and training services through non-governmental organizations</li> </ul>  |
| 5. Community orientation and social investment funds            | <ul style="list-style-type: none"> <li>- Objective: to improve the situation of beneficiaries and the communities in which they live</li> <li>- Develop local action capacity</li> <li>- Develop communities’ social capital</li> </ul>                | <ul style="list-style-type: none"> <li>- Self-construction of basic social infrastructure</li> <li>- Formalization and regularization of land and housing</li> <li>- Strengthening of community organizations</li> </ul>  | <ul style="list-style-type: none"> <li>- Participatory social investment fund (Argentina): development of local action capacity in areas with predominantly indigent populations, free meal canteens in community projects</li> <li>- “Viver Melhor” (Brazil): reduction of the urban housing deficit</li> <li>- “Iniciativa Ciudadana 2x3” (Mexico): co-financing of local initiatives that help to guarantee access to basic services among population groups living in extreme poverty</li> <li>- Land titling (Costa Rica)</li> </ul>                           |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Marcia Pardo, “Reseña de programas sociales para la superación de la pobreza en América Latina”, *Estudios estadísticos y prospectivos series*, No. 20 (LC/L.1906-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2003.

The aim of public programmes focusing on production and employment is to enhance productive capacity among the poorest sectors through vocational skills acquisition and training components, proposals for productive projects and improved access to credit and microcredit. The early 1990s were also characterized by a series of community-oriented programmes and social investment funds that prioritized community participation in the process of improving those same communities' living standards. All of these initiatives have been designed to upgrade individual and collective skills by building social capital and local management capacity.

A number of social programmes aimed explicitly at human capital development have been implemented in the region —specifically, programmes on nutrition, childcare, education, health, training, housing, infrastructure and sanitation (Acosta and Ramírez, 2004). Given the increasing emphasis placed on social programmes and synergies among the different dimensions of human capital as a factor for development and overcoming poverty in the long term, this chapter devotes special attention to conditional transfer programmes, which have been applied in a number of countries in the region and have broad innovative potential. Moreover, as mentioned above, social programmes need to take into account the prevailing economic situation, especially when it restricts households' chances of earning enough income to satisfy their basic needs. The chapter also reviews employment-related emergency programmes, which have broad coverage and visibility in times of crisis. Although these programmes by no means exhaust the spectrum of policies for dealing with poverty and promoting greater social protection among the most vulnerable, they illustrate a very timely and relevant approach that combines emergency short-term support, medium- and long-term capacity-building, and measures designed to facilitate productive opportunities as a means of linking the immediate horizon with a strategic outlook.

A number of other high-budget, broad-coverage or innovative social programmes launched in the region over the past few years are also noteworthy for a variety of reasons.

One way to foster human capital development among the population is by providing free and universal access to health care, education and social protection, as in Cuba. One of the features of that country's social policy is its coordination with economic policy, which is why its budgetary appropriations for social services are among the highest in the region. Cuba's integrated system comprises 167 social programmes which absorb more than 65% of the government budget. Some of the main lines of action in this area include institutionalized programmes focusing on the provision of free and universal access to education and health care, protection of workers' employment and housing, food subsidies and mechanisms to assist vulnerable families. Recently an effort has been made to adapt these programmes to provide a more personalized response in pursuing their chief objectives of protecting at-risk groups and reducing vulnerability.

Other initiatives worth noting include the missions set up in the Bolivarian Republic of Venezuela (including the "Mercal" mission, which sells low-priced food products directly, the "Barrio Adentro" health mission, and the "Robinson" basic literacy mission), programmes such as the children's welfare homes run by the Instituto Colombiano de Bienestar Familiar (Colombia) and the Programa de Atención Integral a la Niñez Nicaragüense (Nicaragua), training and teaching programmes (including the comprehensive improvement course for young people in Cuba, the "Jóvenes en Acción" programme in Colombia, the worker training scholarship programme in Mexico, and the national programme for workers' skill development in Brazil), programmes for mothers and children (including "Arranque Parejo en la Vida" in Mexico and the free maternity programme in Ecuador), and community kitchen programmes for children throughout the region.

## Employment-related emergency programmes

### Reduction of vulnerability

This section describes the main characteristics and key effects of employment-related emergency programmes, which have been applied in a number of countries across the region and have generally had wide coverage.<sup>5</sup> Programmes of this type originated as emergency measures to alleviate the effects of the crisis that struck the region in the 1980s. Since then they have become one of the Latin American and Caribbean countries' habitual responses to high rates of unemployment and to the increase in informal activity and poverty caused by the region's low and volatile rates of economic growth. The macroeconomic volatility that has prevailed over the last two decades translates into ever shorter business-cycle swings in activity and investment, with destructive effects on the assets of the poor (especially in terms of access to quality jobs) and on their capacity to accumulate human capital. These programmes have direct countercyclical effects on household incomes (enabling families to increase their resources under adverse economic circumstances) and play a major role in furnishing social protection by transferring funds to prevent family incomes from falling below critical levels. The transfers received by households also protect their human capital, particularly by improving food security and encouraging young people not to drop out of school.

While originally linked to the business cycle and crises, problems of structural unemployment and the persistence of poverty in the region have turned these programmes into increasingly permanent measures that are less and less related to that cycle. They can therefore be viewed as poverty reduction programmes that make use of employment-related measures.<sup>6</sup>

### General characteristics

Table V.2 lists several examples of employment programmes and provides detailed information on their objectives, target population and access conditions; these programmes range from initiatives launched in the 1970s (including the Chilean minimum employment and heads of household employment programmes implemented between 1975 and 1988) to quite recent efforts (including the Uruguayan national social emergency plan, introduced in 2005). Employment-related emergency programmes typically provide short-term jobs to semi-skilled or unskilled workers in labour-intensive projects involving the creation or repair of economic, social and community infrastructure.

In exchange for their participation in such projects, beneficiaries receive payment in the form of cash or food transfers. The operational advantages of these programmes as mechanisms for responding to crisis situations include their great flexibility, their potential for rapid deployment, and the fact that they can draw on resources and capacities from the tertiary sector, firms and beneficiary communities themselves. Increasingly, the aim is to relate these programmes to more general initiatives by making benefits conditional on school attendance (“Jefas y Jefes de Hogar Desocupados” programme in Argentina) or by establishing links with the general social safety net. Some programmes (such as those implemented in recent years in Chile and Uruguay) include the payment of social security and health contributions and coverage of workplace accident insurance (“Trabajar en Argentina”, “A Trabajar Urbano” in Peru and the Plan Nacional de Empleos de Emergencia in Bolivia), which creates links with the general social protection system.

<sup>5</sup> Although these initiatives are normally referred to as “emergency employment programmes”, in many cases the fulfilment of employment requirements is somewhat ambiguous. Accordingly, in this chapter it is considered preferable to use the more precise term of “employment-related emergency programmes”.

<sup>6</sup> This chapter focuses on temporary employment programmes considered as social protection initiatives. Pardo (2003), Acosta and Ramírez (2004) and Tokman (2005) provide further information on passive policies (subsidized hiring in firms, training, credit) and other active employment policies. Velásquez (2005) contains a description of unemployment insurance schemes in the region.

Table V.2

**EXAMPLES OF EMERGENCY PROGRAMMES LINKED TO EMPLOYMENT IN LATIN AMERICA AND THE CARIBBEAN, 1975-2005**

| Programme   | Objective  | Target population   | Conditions  |
|---|--|---|---|
| Plan Jefes y Jefas de Hogar Desocupados (Argentina, since 2002)                               | <ul style="list-style-type: none"> <li>- Temporary employment for unemployed heads of household</li> <li>- Conservation of human capital in education and health</li> </ul>            | Unemployed heads of household with dependants (under 18s, disabled or pregnant)   | <ul style="list-style-type: none"> <li>- Participation for 20 hours a week in projects to create and repair economic and social infrastructure</li> <li>- Children's attendance at school and primary health services</li> </ul>  |
| Plan Trabajar en Argentina (Argentina, 1995-2002)   | <ul style="list-style-type: none"> <li>- Temporary employment for unemployed heads of household</li> </ul>   | Unemployed heads of household from poor families  | <ul style="list-style-type: none"> <li>- Participation for at least six hours a day in activities to repair and create economic and social infrastructure</li> </ul>  |
| Programa de Empleo Temporal (PET) (Mexico, since 1995)  | <ul style="list-style-type: none"> <li>- Resolution of structural problems that hinder employment in marginalized rural zones</li> <li>- Disaster response</li> </ul>                  | Rural population over 16 years of age living in extreme poverty<br>Priority: communities included in the micro-region development programme | <ul style="list-style-type: none"> <li>- Repair and recovery of infrastructure or heritage</li> <li>- Projects to create productive and social infrastructure</li> <li>- Family capital formation (repair of housing)</li> <li>- Time-limited to 88 working days (four months)</li> </ul> |
| Empleos en Acción (Colombia, 2000-2004)   | <ul style="list-style-type: none"> <li>- Complementary income for the poorest urban population groups</li> <li>- Temporary employment</li> <li>- Creation of infrastructure</li> </ul> | Unemployed adults not participating in training programmes, from the poorest 20% of the population (SISBEN categories 1 and 2)              | <ul style="list-style-type: none"> <li>- Half-day participation in labour-intensive projects to repair or create basic infrastructure in localities belonging to the poorest 40% in urban areas</li> </ul>  |
| Manos a La Obra, Vías Para La Paz (Colombia, 2000-2004)                                       | <ul style="list-style-type: none"> <li>- Economic integration of areas affected by violence</li> <li>- Development of highway infrastructure</li> </ul>                                | Economically depressed zones and those affected by high levels of violence  | <ul style="list-style-type: none"> <li>- Projects to improve transport infrastructure</li> </ul>  |
| Programa de Mejoramiento Urbano (Chile, since 1987)   | <ul style="list-style-type: none"> <li>- Temporary employment</li> <li>- Community infrastructure and equipment</li> </ul>   | Unemployed workers, registered at municipal employment information offices  | <ul style="list-style-type: none"> <li>- Participation in projects to create community infrastructure</li> </ul>  |
| Programa de Empleo, Fondo Social de Absorción de Cesantía (FOSAC) (Chile, since 1999)         | <ul style="list-style-type: none"> <li>- Temporary employment</li> <li>- Satisfaction of basic needs among the poorest groups</li> </ul>   | Unemployed workers, registered at municipal employment information offices  | <ul style="list-style-type: none"> <li>- Full-time, three-quarters time or half-time participation in infrastructure works</li> </ul>   |
| Programa de empleos de emergencia - National Forestry Corporation (CONAF) (Chile, since 2001) | <ul style="list-style-type: none"> <li>- Temporary employment</li> <li>- Creation of infrastructure</li> </ul>   | Unemployed rural workers, registered at municipal employment information offices  | <ul style="list-style-type: none"> <li>- Three-quarters time (2001) or half-time (2002) participation in infrastructure creation or environmental conservation works</li> </ul>   |
| Programa Proempleo, Inversiones en la Comunidad (Chile, since 2001)                           | <ul style="list-style-type: none"> <li>- Temporary employment</li> <li>- Improvement of quality of life among the community</li> </ul>   | Unemployed workers, registered at municipal employment information offices  | <ul style="list-style-type: none"> <li>- Participation in labour-intensive physical or social works in the local domain</li> </ul>  |
| Programa de Generación de Empleos (Chile, 1998-2000)  | <ul style="list-style-type: none"> <li>- Absorption of unemployed labour</li> </ul>  | Unemployed workers registered at municipal offices  | <ul style="list-style-type: none"> <li>- Labour-intensive infrastructure projects</li> </ul>  |
| Minimum employment programmes (Chile, 1975-1988)  | <ul style="list-style-type: none"> <li>- Reduction of unemployment at times of economic adjustment</li> </ul>  | Unemployed adults of both sexes   | <ul style="list-style-type: none"> <li>- Labour-intensive economic and basic social infrastructure projects</li> </ul>  |
| Plan de Atención Nacional a la Emergencia Social (PANES) (Uruguay, since 2005)                | <ul style="list-style-type: none"> <li>- Temporary employment</li> </ul>   | Unemployed adults of both sexes   | <ul style="list-style-type: none"> <li>- Creation and repair of infrastructure</li> </ul>   |
| Programa Actividades Comunitarias (Uruguay, since 2004)                                       | <ul style="list-style-type: none"> <li>- Temporary employment</li> </ul>   | Unemployed  | <ul style="list-style-type: none"> <li>- Six hours' work per day</li> </ul>   |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Pablo Villatoro, "Los nuevos programas de protección social asistencial en América Latina y el Caribe", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished; and "Programas de reducción de la pobreza en América Latina. Un análisis de cinco experiencias", *Políticas sociales series*, No. 87 (LC/L.2133-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), May 2004. United Nations publication, Sales No. S.04.II.G.62.

A comparison of the most recent initiatives with first-generation programmes reveals an expansion in the scope of intervention to include actions that are more than simply a response to macroeconomic contraction. In practice, temporary employment programmes are being used in Latin America and the Caribbean to address phenomena as wide-ranging as the seasonality of agricultural activities, the impacts of natural disasters, the consequences of armed conflicts, the risks associated with environmental damage and food insecurity. Moreover, given the persistence of poverty and the high level of structural unemployment, such programmes are no longer exclusively countercyclical but constitute tools in the general effort to combat poverty, which explains why they are often continued once the recession or crisis has passed, as has occurred in Argentina, Chile and Uruguay over the last two years. The feature that all the activities listed in table V.2 have in common is that benefits are contingent upon the beneficiaries' participation in employment-related activities (fulfilment of counterpart work requirements, attendance at training courses, participation in job searches, etc.).

In exchange for their labour contributions, beneficiaries basically receive cash transfers such as those mentioned in table V.3.<sup>7</sup> In relative terms, the transfers are worth between 43% and 100% of the minimum wage, except in the cases of "Programa Proempleo" in Chile and "Empleos en Acción" in Colombia, which pay benefits above the legal minimum wage. In some cases, the requirement of a labour contribution and the relatively low level of the benefits provided are explicitly designed as self-screening mechanisms.<sup>8</sup>

In terms of the number of beneficiaries, some programmes cover a large fraction of the economically active population (EAP). Examples include the "Jefes y Jefas" programme in Argentina (10.7%), the direct employment programmes in Chile (7.8%), and PANES in Uruguay (7.2%). The size of the programme is also reflected in the level of public expenditure it represents: the average expenditure of programmes in relation to GDP is 0.43%, although in some cases it rises to 1%; in several cases a high proportion of expenditure is financed externally by multilateral lending agencies (Villatoro, 2005).

## Assessments and challenges

Employment-related emergency programmes have proven to be relatively effective mechanisms for responding to crisis situations by providing incomes to the population groups that are most vulnerable to economic crises. In terms of targeting, these programmes have been relatively successful because, at least in the cases for which information is available, most beneficiaries have been below the poverty or indigence threshold. For example, 80% of beneficiaries in the "Trabajar" programme came from the poorest 20% of households in Argentina (Jalan and Ravallion, 1999); and 89.8% of workers included in the "Programa de emergencia social productivo" (PESP) in Peru were below the poverty line (Pichihua, 2002). In addition, in the "A Trabajar Urbano" and "Jefes y Jefas" programmes in Argentina, 90% of participants came from the poorest 60% of households.

Evaluations show that the positive effects in terms of short-term monetary incomes particularly favour women and that the programmes with the broadest coverage have succeeded in reducing the aggregate rate of extreme poverty. For example, in the "Jefes y Jefas" programme, poverty among participants fell from 82% to 70%, and extreme poverty dropped from 51% to 29% (Galasso and Ravallion, 2003). In Mexico's temporary employment programme (PET), 60% of participants ended up above the extreme poverty threshold, but there is no empirical evidence of effects on income in the medium and long terms. Once participation in the "Jefes y Jefas" programme ended, there was a decline in the incomes of its former beneficiaries, which stood at three quarters of the transfer in the first six months and at just under half after 12 months (Ravallion and others, 2001). In contrast, Chile's direct employment programmes have had a positive effect on their beneficiaries' monetary incomes (Bravo, Contreras and Medrano, 2004).

<sup>7</sup> The food security programmes supported by the World Food Programme (WFP) include transfers in kind.

<sup>8</sup> On this point, see Subbarao (1997, 2002) and Ravallion (1998).

Table V.3

**BENEFITS, COVERAGE, TARGETING, EXPENDITURE AND FINANCING OF EMPLOYMENT-RELATED EMERGENCY PROGRAMMES  
IN LATIN AMERICA AND THE CARIBBEAN**

| Programme   | Monthly benefit<br>(in dollars)        | Benefit/minimum<br>wage                               | Percentage of EAP          | Percentage below<br>poverty line | Expenditure/GDP | External Financing <sup>o</sup>  |
|---|--|---|----------------------------|----------------------------------|-----------------|--|
| Plan Jefes y Jefas de Hogar Desocupados (Argentina)   | 45                                     | 0.75 (2002) <sup>g</sup><br>0.43 (2004) <sup>h</sup>  | 10.7% <sup>j</sup>         |                                  | 0.8% (2003)     | 0% (2001-2002)<br>30% (World Bank, 2003-2005)                            |
| Plan Trabajar en Argentina  | 200 (1996-1998)<br>160 (1999-2002) *** | 1 (1996-1998) <sup>g</sup><br>0.8 (1999) <sup>g</sup> | 2.7% <sup>k</sup>          | 80.0 <sup>i</sup>                | 0.02%           | 100% (World Bank, 1997-1999)<br>26% (World Bank, 1998-2002)              |
| Programa de Empleo Temporal (PET) (Mexico)  | 81.05 (2004) <sup>a</sup>              | 0.99 (2004)   | 2.4%, 11% rural (2001)     |                                  | 0.29%           |  |
| Empleos en Acción (Colombia)  | 84.66 (2000) <sup>b</sup>              | Greater than one                                      | 1.8% <sup>l</sup>          |                                  |                 |  |
| Manos a la Obra, Vías para la Paz (Colombia)  | 84.66 (2000) <sup>b</sup>              | Greater than one                                      |                            |                                  | 0.22%           | 52% (World Bank, 2000-2005)  |
| Programa de Mejoramiento Urbano (Chile)   | 179.66 (2003) <sup>c *</sup>           | 1.1 (2003)  | 7.79 (2001)                | 62.0                             | 0.24%           |  |
| Programa de Empleos de Emergencia, CONAF (Chile)  | 146.02 (2001) <sup>c *</sup>           |   |                            | 71.7                             |                 |  |
| Programa Proempleo, Inversiones en la Comunidad (Chile)   | 308.27 (2001) <sup>c *</sup>           | 1 – 1.53 (2004)                                       |                            | 68.5                             |                 |  |
| Programa de empleo, FOSAC (Chile)   |  | 1.13 (2003)   |                            | 69.9                             |                 |  |
| Programa de Generación de Empleos (Chile)   | 150 (1999) <sup>*</sup>                | 1   |                            |                                  |                 |  |
| Plan Atención Nacional Emergencia Social (PANES) (Uruguay)  | 55.2 (2005) <sup>d</sup>               | 0.66  | 7.2% (2005) <sup>l m</sup> |                                  | 0.5% (2005)     |  |
| Programa Actividades Comunitarias (Uruguay)   | 41 <sup>*</sup>                        | 1   | 0.5% (2003)                |                                  | 0.01%           | 0%   |
| A Trabajar Urbano (Peru)  | 86 (2002) <sup>**</sup>                | 0.73  | 0.2% urb. (2002)           | 48.0 <sup>i</sup>                | 0.16%           | 0%   |
| A Trabajar Rural (Peru)   | 86 (2002)                              | 0.73  |                            | 23.0 <sup>i</sup>                |                 |  |
| Programa Emergencia Social Productiva (Peru)  | 86 (2002)                              | 0.73  |                            | 89.8                             |                 |  |
| Programa de Apoyo al Ingreso Temporal (Peru)  | 45 (1985)                              | 1   | 1.78% (1985-1987)          |                                  |                 |  |
| Programa Emergencial de Fontes Productivas (Brazil)   | 45                                     | 0.6   | 1.67% (1998)               |                                  |                 |  |
| Plan Nacional de Empleos de Emergencia (Bolivia, 2002)  | 63 <sup>c **</sup>                     |   | 1.6% (2002)                |                                  | 0.86%           | 100% (international cooperation)   |
| Fondo de Emergencia Social (Bolivia)  |  |   | 1.13% (1990) <sup>n</sup>  | 80.0%                            | 1.0% (1990)     | 90% (IDB, 1995)  |
| Fondo de Inversión Social de Emergencia (Nicaragua)   | 93.8 <sup>f</sup>                      |   | 1.12%                      | 23.0 <sup>i</sup>                | 0.7% (1991)     |  |
| Food for work programmes run by the World Food Programme (WFP) in Bolivia, El Salvador, Guatemala, Nicaragua and Peru | Food rations                           |   | 0.02% Peru <sup>l</sup>    |                                  |                 | 45% Peru 2000-2005<br>78% Guatemala 2001-2004<br>82% Nicaragua 2002-2006 |

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Pablo Villatoro, "Los nuevos programas de protección social asistencial en América Latina y el Caribe", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished; and "Programas de reducción de la pobreza en América Latina. Un análisis de cinco experiencias", *Políticas sociales series*, No. 87 (LC/L.2133-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), May 2004. United Nations publication, Sales No. S.04.II.G.62.

**Note:** Additional benefits: \* Payment of social security contributions (health and pensions); \*\* Workplace accident insurance; \*\*\* Civil responsibility and health coverage insurance.

<sup>a</sup> Remuneration of 42 pesos/working day, 22 working days/month. <sup>b</sup> Dollar as at June 2000, Banco de la República de Colombia. <sup>c</sup> Includes social security contributions. <sup>d</sup> Dollar as at 27/06/05, Central Bank of Uruguay. <sup>e</sup> Wage of manual workers. <sup>f</sup> Average expenditure per beneficiary. <sup>g</sup> Minimum living wage (SMV) of \$200, in force between 1993 and 2003. <sup>h</sup> SMV of \$350, in force since 2003. <sup>i</sup> Percentage in the poorest quintile. <sup>j</sup> EAP 2000. <sup>k</sup> EAP 1995. <sup>l</sup> Projected number of jobs created. <sup>m</sup> EAP 2001. <sup>n</sup> Average annual number of jobs 1986-1990. <sup>o</sup> Based on the amounts of projects approved by borrowers or donors.

In terms of employment, these programmes have had positive effects in creating temporary short-term jobs. In the case of “Jefes y Jefas”, for example, 26% of the beneficiaries would not have found employment and 23% would have been inactive if the programme had not been implemented.<sup>9</sup> In the PET programme in Mexico, there was a significant increase in the number of days worked (Samaniego, 2002). Participants in the “Empleos en Acción” programme in Colombia showed a 36% increase in the number of hours worked per week (Villatoro, 2005), while beneficiaries in Chile’s direct employment programmes saw their chances of obtaining a job improve from 11% to 38%, depending on the year in which they joined the programme (Bravo, Contreras and Medrano, 2004).

There is no consensus regarding the capacity of temporary employment programmes to create stable jobs. Acosta and Ramírez (2004) and Sojo (2003) contend that such programmes are ineffective in creating permanent employment because of the poor quality of the jobs they provide and because they do not include job training or placement services. Nor is there any systematic evidence as to the contribution made to human capital formation among the children of beneficiary families.

The effect of temporary employment programmes in terms of creating infrastructure for the poorest communities has not yet been systematically assessed in these evaluations, even though this is usually one of the explicit objectives. Nonetheless, the available information shows that “Trabajar” made it possible to undertake over 10,000 projects benefiting 300,000 people per year, most of whom were residents of poor communities (Berra and Jones, 2003). The “Empleos en Acción” programme in Colombia approved 3,845 projects, but works were only completed in 2,788 cases (74.9%), generally because of a lack of funding (Villatoro, 2005).

In terms of these programmes’ cost structures, the administrative overhead is relatively high. Morley and Coady (2003) state that temporary employment programmes are less cost-effective than transfer programmes conditional on investment in human capital (the topic analysed in the next section), which makes them relatively expensive modalities of income transfer to the poorest groups. Moreover, some direct employment programmes are less cost-effective at creating permanent jobs than indirect employment programmes (Bravo, Contreras and Medrano, 2004).<sup>10</sup>

Generally speaking, one of the continuing challenges faced by these programmes is the need to endow beneficiaries with new productive capacities (providing training or requiring that they engage in a decent and productive job in community projects among other things) and to avoid lapsing into a situation where they are simply providing those beneficiaries with unrequited subsidies. In view of the lack of information on the long-term effects on beneficiary employability, steps should be taken to ensure that the work experience offered by these programmes and their linkages with production policies have the effect of strengthening their training, skills-acquisition and work-habits components.

Another challenge that these programmes have to face is the higher incidence of poverty in households that are headed by women and those that are in the expansionary phase of the family life cycle. In particular, women who are the heads of households with several small children usually face conflicts between their childcare obligations, household chores, and the need to go out to work to support the family. These conflicts need to be taken into account in the design of such programmes to ensure that they benefit those who need them most.

In terms of design, a common characteristic of emergency plans and programmes aimed at responding to crisis situations is the urgency with which they are applied in an effort to cope with exceptional situations. The lack of predefined emergency plans results in delays in the targeting and delivery of necessary funds to those who need them. Such problems of design and application

<sup>9</sup> In this programme, as elsewhere, participants are classified as active although in practice major obstacles have often been encountered in enforcing the labour contribution (including the mass nature of the programme in the case of “Jefes y Jefas”).

<sup>10</sup> These calculations do not consider benefits arising from the reduction of human capital risk (e.g., guaranteed basic levels of food consumption, which would lead to a long-term increase in productivity) or benefits arising from the creation of community infrastructure (Subbarao, 2002).

translate into a failure to fulfil eligibility requirements<sup>11</sup> and labour contributions, lack of transparency in their administration, and a clientilistic use of resources —features that undermine both the effectiveness and the legitimacy of the actions taken. Another common problem is a lack of suitable planning in regard to the duration of benefits or explicit (and predefined) rules for the beneficiary's exit from the programme.

In fact, some programmes have tended to last longer than intended because of a lack of explicit guidelines for bringing them to an end once the crisis is over.<sup>12</sup> Temporary employment programmes need to be flexible enough to expand and contract in response to economic circumstances,<sup>13</sup> so as to avoid generating a high degree of welfare dependency among the beneficiaries.

Programmes should include tools and mechanisms to help beneficiaries make the transition to permanent employment, through productive initiatives, training programmes and job search assistance.<sup>14</sup> They should also channel beneficiaries towards other social programmes as necessary, with a view to integrating programmes into the spectrum of ongoing interventions in the effort to combat poverty.<sup>15</sup>

One of the most controversial aspects of temporary employment programmes has been the decision as to what level of transfer payments is most appropriate to fulfil equity goals (maximum participation in programmes by the poorest groups) and efficiency objectives (maximizing the welfare of target groups, without introducing employment disincentives).

The most common practice consists of paying low wages as a targeting mechanism based on beneficiary self-selection, thereby discouraging individuals from participating in the programme if they already have a job or are in a position to work. One criticism of this practice is that it limits the effectiveness of the transfer in terms of reducing poverty and hinders the absorption of open unemployment in the short run, since it encourages underemployed and inactive groups to participate in the programme (Acosta and Ramírez, 2004; Reinecke, 2005). Although it might be argued that a relatively high benefit level accentuates targeting errors and introduces a disincentive to labour-market participation among the beneficiaries (Subbarao, 2002; Ravallion, 1998), the restriction of incentives loses relevance in situations of mass poverty and unemployment. At times of widespread crisis, targeting errors are a secondary problem compared to the primary goal of delivering support to the most vulnerable households.

The issue of incentives becomes more important in the case of programmes that continue after emergency situations have ended. In such cases, to ensure adequate targeting, benefits should be based on a combination of relatively high transfer levels and alternative targeting procedures to ration employment, such as using seasonal criteria or selecting poor areas.

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<sup>11</sup> These implementation problems, which are recurrent in programmes such as “Trabajar” and “Jefes y Jefas” in Argentina (Galasso and Ravallion, 2003), are not exclusive to programmes implemented at times of crisis. For example, in the direct employment programmes implemented in Chile, 62.3% of beneficiaries had some paid activity at the start of the programme, and only 19.3% were unemployed. Moreover, 34% of beneficiaries were not heads of household (Bravo, Contreras and Medrano, 2004).

<sup>12</sup> For example, in 2000-2004, the beneficiaries of Chile's direct employment programmes participated for an average of 18.5 months. A similar situation was noted in the “Jefes y Jefas” programme in Argentina, in which the beneficiaries participated for longer than originally envisaged (Reinecke, 2005).

<sup>13</sup> Other mechanisms to limit the unnecessary extension of programmes include the establishment of unemployment thresholds and the adoption of gradual closure mechanisms, by reducing the working day, gradually lowering the wage and imposing time-limits on beneficiary participation (Bravo, Contreras and Medrano, 2004).

<sup>14</sup> Other mechanisms that can be used for the same purposes are subsidized hiring in firms, and credits and technical assistance for self-employment purposes. See Pardo (2003), Acosta and Ramírez (2004) and Tokman (2005).

<sup>15</sup> On this point, it is worth noting that the “Jefes y Jefas” programme in Argentina did not have clear exit rules. The programme has been under way for three years, and beneficiaries are being directed towards training programmes or the “Familias” plan.

## Human capital and long-term effects: conditional transfer programmes

### Breaking the cycle of intergenerational transmission of poverty: traditional interventions and the new generation of programmes

Poverty influences the development opportunities that families pass on from one generation to the next. The profiles of households in the highest and lowest deciles of the income scale show that differences in nutrition, education, wealth, and occupational and demographic factors are mutually reinforcing, with the result that young people from low-income households are at a disadvantage during adulthood (ECLAC, 2000c). As has been argued in many previous ECLAC publications, the low educational levels of large sectors of the population, especially in the poorest countries, are a key mechanism in passing on poverty to the next generation: low levels of schooling and lack of access to quality education for young people from the poorest strata block their main channel of mobility and social inclusion.<sup>16</sup> Moreover, insufficient food and unequal access to infrastructure (drinking water, sanitation) and proper health services inhibit physical development, which makes knowledge acquisition even more difficult.

It is not surprising, therefore, that social programmes in Latin America and the Caribbean have a long history of interventions aimed at overcoming the low level of human capital accumulation (in educational, health and nutritional terms) found among poor families. These interventions made use of a variety of mechanisms in different contexts, with varying levels of coordination, to provide opportunities and improve the family and community environment (see box V.2).

Over the past few years, these traditional interventions have been complemented by a new generation of social programmes that combine immediate alleviation of income poverty with human capital components for young people. The aim is to create positive synergies between these short- and long-term objectives and between the different dimensions of human capital.

### General characteristics of conditional transfer programmes

Conditional transfer programmes usually involve a transfer of funds to poor families, who, in return, undertake to meet certain educational, health and nutrition targets (see table V.4). The combination of monetary (or in-kind) assistance with education or health-care requirements makes it possible to combine short-term poverty relief with long-term objectives by developing human capital assets with a view to overcoming the intergenerational reproduction of poverty. Programmes of this type are premised on the fact that the poorest people lack opportunities and are unable to cope adequately with adverse situations and thus sustain major losses of human capital in terms of education, health or both.

These programmes represent a novel synthesis, combining innovative elements with certain features of interventions that have a long track record in the region. Examples of the latter are direct monetary transfers to families (included in numerous welfare programmes), conditionality (included in the employment-related emergency programmes described in the previous section) and multisectoral interventions (included in school meals programmes, among others).

<sup>16</sup> As pointed out by Machinea and Hopenhayn (2005) in relation to some of the region's countries, only about 20% of young people whose parents have not completed primary school manage to do so themselves. In contrast, the proportion exceeds 60% in cases where parents have completed 10 or more years of schooling. Between 48% and 64% of young Latin Americans from urban areas have their future life chances compromised as a result of their family backgrounds: the educational level of their parents, a decisive variable for the educational climate of the household, is closely related to the educational path followed by their children. These factors are further aggravated for young people living in rural areas.

## Box V.2

**PROTECTING HUMAN CAPITAL AND FOSTERING ITS DEVELOPMENT  
IN CHILDHOOD AND ADOLESCENCE**

Countries in the region have adopted a variety of initiatives to develop and protect human capital in childhood and adolescence, ranging from programmes to expand the supply of education to those specifically aimed at ending child labour.

Of particular importance are various types of school meal programmes, which have achieved synergies between education, nutrition and the well-being of the family, since they constitute an implicit transfer to the whole household. These initiatives have a long history in the region (the school meals programme in Brazil has been in operation since 1953) and have succeeded in improving the population's educational capital by reducing school dropout rates and absenteeism among disadvantaged children, while also providing a minimum calorie intake, which is a necessary condition for learning. School meal programmes also transmit knowledge and habits regarding adequate nutrition, and programmes started in the past few years have extended the service to weekends and holiday periods (Acosta and Ramírez, 2004). Numerous countries in the region have implemented programmes of this type (highly nutritious breakfasts, lunches, or both), with varying degrees of pupil coverage. Available information shows that such programmes make a significant improvement in the nutritional status of schoolchildren when they are implemented on a sustained basis. They also enhance pupils' educational performance and reduce dropout rates (Pardo, 2003). Early human capital investments of this type yield considerable returns at a relatively low cost compared to the benefits they provide.

Regional efforts to protect the preschool population have been channelled through mother and child health care programmes which monitor the health status of small children and combat the main causes of childhood illness through timely immunization. They also usually include measures to encourage breast-feeding in the first six months of life and the provision of food supplements. Another line of action for preschool children which is quite widespread in the region focuses on comprehensive care for under-sixes (nutritional and health care and psycho-affective development) in low-income households. Among many others, examples include actions undertaken in the crèche and kindergarten programmes in Chile; "Madres Cuidadoras" and "Hogares de Cuidado Diario" in the Bolivarian Republic of Venezuela; the "Protección a la Infancia y Adolescencia" programme in Mexico; the national alternative preschool education programme "Operación de Rescate Infantil" and "Nuestros Niños" in Ecuador; the "De la Mano" programme in Costa Rica; the children's welfare homes of the Instituto Colombiano de Bienestar Familiar (ICBF) in Colombia; and the Programa de Atención Integral a la Niñez Nicaragüense in Nicaragua. Apart from focusing on child development, in some cases these programmes also provide support networks for women participating in the labour force.

There are also a number of programmes aimed at eradicating child labour and reintegrating children into the education system. These include activities carried out over the past few years in the Bolivarian Republic of Venezuela ("Misión Negra Matea", targeting street children), Brazil (PETI, a programme to eradicate child labour), Ecuador (a programme to protect and educate child workers) and Mexico (the "De la Calle a la Vida" and "Explotación sexual comercial infantil" components of the country's child and adolescent protection programme). These initiatives seek to foster social and household attitudes and practices that promote school attendance and the elimination of child labour. Some programmes also provide transfers to compensate for the contribution that children were previously making to household income; these transfers are contingent upon school attendance.

**Source:** Marcia Pardo, "Reseña de programas sociales para la superación de la pobreza en América Latina", *Estudios estadísticos y prospectivos series*, No. 20 (LC/L.1906-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2003.

The main innovations consist of the overarching emphasis placed on the co-responsibility of beneficiary families; conditionality used as an incentive at the family level (rather than as a mechanism for self-selection and targeting) and as a means of coordinating short- and long-term targets; the explicit priority given to the search for sectoral synergies in human capital accumulation, not only among school-age children but also in early childhood; and the predominant role accorded to women as benefit recipients and in their role in implementation and monitoring. Many of these programmes have abundant resources and apply relatively clear eligibility criteria. This enables them to achieve broad coverage, unlike earlier programmes that tended to focus on limited geographic areas or were governed by vaguer rules of admission. Table V.4 lists the main programmes involving transfers that are conditional on human capital investment implemented in Latin America and the Caribbean over the last 15 years. Among other features, the table lists the objectives, components, target populations, requirements and resource allocations.

Table V.4  
**EXAMPLES OF CONDITIONAL TRANSFER PROGRAMMES IN LATIN AMERICA AND THE CARIBBEAN, 1990-2005**

| Programme   | Objectives   | Components (type)  | Target population  | Conditions   | Beneficiaries/<br>population | Expenditure/<br>GDP |
|---|--|--|--|--|------------------------------|---------------------|
| Familias por la Inclusión Social (Argentina, 2005)                              | Promotion of child development, health, and permanency in the education system, while preventing exclusion among poor families   | - Education (one-dimensional)  | Poor families with children under 19 years of age or pregnant women not receiving subsidies from other social programmes   | - School attendance<br>- Attendance at health centres  |                              |                     |
| Con todo derecho. Programa de ciudadanía porteña (Argentina, 2005)              | Promotion of children's health and permanency in the school system, and reduction of social exclusion. Unification of social programmes in the city of Buenos Aires                          | - Education<br>- Health<br>- Nutrition (card-based) (multidimensional)   | Indigent families with non-adult children, pregnant women, older adults, or individuals with some type of disability in the city of Buenos Aires. Distribution of a smart card for the purchase of food and fuel | - School attendance<br>- Periodic health check-ups for expectant mothers and children<br>- In future: job search and training for unemployed adults      |                              |                     |
| Bolsa Familia (Brazil, 2003)  | Reduction of poverty and inequality in the short and long term.  | - Education<br>- Health<br>- Nutrition (multidimensional)  | Families with children in extreme poverty, per capita income of US\$ 17 per month  | - School attendance<br>- Family health-care calendar (inoculations and periodic visits to health centres)  | 16%                          | 0.28% (2003)        |
| <i>Bolsa Escola</i> (Brazil, 1995-2003)   | Extending permanency in primary and secondary education, and prevention of child labour  | - Education (one-dimensional)  | Families with children in moderate poverty, income per capita between 17 and US\$ 34 per month   | - 80% - 85% school attendance  | 4.79%                        | 0.13%               |
| <i>Bolsa Alimentação</i> (Brazil, 2001)   | Reduction of child mortality and under-nutrition, and linkage to the health-care system among families at nutritional risk   | - Health<br>- Nutrition (multidimensional)   | Children between six and 15 years of age, belonging to families with monthly per capita incomes of up to 90 reais  | - Attendance at prenatal and nutritional health check-ups, inoculations and child development  |                              |                     |
| Programa de erradicación del trabajo infantil (PETI) (Brazil, urban since 1999) | Elimination of the worst forms of child labour, including those that represent a health danger, in rural and urban zones   | - Education (one dimensional)  | Families with per capita incomes less than 15 reais, with pregnant or breast-feeding women, and children under six years 11 months of age at nutritional risk  | - 80% school attendance.<br>- Participation in extended school day   | 0.45%                        | 0.04% (2001)        |
| Chile Solidario (Chile, 2002)   | Comprehensive support for families living in conditions of indigence and critical poverty  | - Health<br>- Education<br>- Decent housing<br>- Employment<br>- Family dynamic<br>- Identification (multiprogramme) | Families with per-capita incomes below half of the minimum wage (US\$ 65 per month) with school-age children (7-14 years), in rural and urban areas  | - Fulfilment of 53 minimum conditions in education, health, identification, habitability, family dynamic, monetary incomes and work                      | 6.45%                        | 0.10% (2004)        |
| Familias en Acción (Colombia, 2001)   | Protection and incentives for human capital formation among children from 0 to 17 years of age in poor households, through support for family investments in health, nutrition and education | - Education<br>- Health<br>- Nutrition (multidimensional)  | In urban areas, children between 10 and 14 years of age involved in prostitution, drug trafficking, refuse collection and street trade   | - 80% school attendance<br>- Attendance at health-care centres for child growth and development check-ups  | 4.01%                        | 0.3%                |
| Superémonos (Costa Rica, 2000)  | Encouragement of access to and permanency in the education system for children and young people living in poverty, through economic incentives   | - Education<br>- Nutrition (multidimensional)  | Poor families with children and adolescents from seven to 18 years of age, attending school  | - School attendance.<br>- Non-use of coupons to buy alcoholic beverages, cigarettes, drugs, or other goods.<br>- Non-transfer of coupons to other people | 1.12%                        | 0.019% (2002)       |

Table V.4 (concluded)

| Programme  | Objectives   | Components (type)   | Target population   | Conditions   | Beneficiaries/<br>population | Expenditure/<br>GDP |
|--|--|---|---|--|------------------------------|---------------------|
| Beca Escolar (Ecuador, 2001)   | Encouragement of access to and permanency in the education system by young people  | - Education (one-dimensional)   | Children between 6 and 15 years of age, enrolled in the school system, belonging to the poorest population quintile   | - 90% school attendance  |                              | 0.05%               |
| Programa de Asignación Familiar (PRAF) (Honduras, 1990)                      | Increase in human capital among children from poor families, to help them to break the poverty cycle   | - Education<br>- Health<br>- Nutrition (multidimensional with supply enhancement)                     | Poor families with:<br>- children between six and 12 years of age that have not completed fourth year of primary education<br>- children under three years of age<br>- disabled children up to 12 years of age<br>- pregnant women<br>- adults over 60 years of age   | - Maximum of seven days' absence from school<br>- Attendance at health centres   | 4.7%                         | 0.019%              |
| Programme of Advancement through Health and Education (PATH) (Jamaica, 2002) | Increase in education and health achievements, reduction of child labour and poverty reduction   | - Education<br>- Health<br>- Nutrition (multidimensional)   | Poor families with children from 0 to 17 years of age, pregnant or breast-feeding women, older adults and disabled  | - 85% school attendance<br>- Attendance at health centres  | 9.07%                        | 0.32% (2004)        |
| Oportunidades (formerly Progresá) (Mexico, 1997)                             | Increase in the capacity of families living in situations of extreme poverty, through human capital investment in the areas of education, nutrition and health | - Education<br>- Health<br>- Nutrition (multidimensional)   | Families below the poverty line (18.9 pesos per day per person in rural areas and 24.7 pesos per day per person in cities), whose members include children from 8 to 18 years of age enrolled in primary or secondary education, children being breast-fed from four to 24 months, children from two to five years of age suffering from under-nutrition, and pregnant and breast-feeding women | - 85% school attendance<br>- Visits to health centres<br>- Attendance at health and nutrition workshops  | 25%                          | 0.32% (2001)        |
| Red de Protección Social "Mi Familia" (Nicaragua, 2000)                      | Incentives for human-capital accumulation among children from poor families in the areas of education, nutrition and health                                    | - Educación<br>- Education<br>- Health<br>- Nutrition (multidimensional with reinforcement of supply) | Children from 0 to 13 years of age from poor families. Children over six must be registered in basic education  | - Fewer than six days of unjustified non-attendance at school<br>- Attendance at health centres<br>- Attendance at health and nutrition workshops<br>- Children's immunizations up-to-date | 1.21%                        | 0.021% (2002)       |
| Tarjeta Solidaridad (Dominican Republic 2005)                                | Reduction of extreme poverty and hunger. Unifies the "Comer es primero" and "Ficha ILAE" (incentive for school attendance) programmes                          | - Education<br>- Health<br>- Nutrition (card-based) (multidimensional)                                | Population living in extreme poverty, identified through the single beneficiary identification system (SIUBEN, a socioeconomic points scoring system). Provision of debit cards in justified cases  | - 85% school attendance<br>- Periodic visits to health centres (frequency to be defined later)   | 12% (future target: 25%)     |                     |
| Proyecto 300 (Uruguay, 2000)   | School attendance by street children   | - Education (one dimensional)   | Street children between 6 and 14 years of age who participate in a socioeducational project of the Instituto del Niño y el Adolescente de Uruguay (INAU)  | - School attendance  |                              |                     |

Source: Pablo Villatoro, "Los nuevos programas de protección social asistencial en América Latina y el Caribe", working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

The type of conditionality used in such social programmes in the region does not vary greatly from one case to another. In the area of education, children are required to maintain a minimum level of school attendance, which varies between 80% and 90%. In health and nutrition, the transfer is conditional on visits to primary health-care centres so that children and their mothers can receive preventive health-care and nutritional services. All the programmes reviewed in this section are based on cash transfers except for “Superémonos” in Costa Rica and the Uruguayan “Proyecto 300”, which distribute food coupons. Another common characteristic is the focus on the family as the basic intervention unit and the important role of women within the household. Women are the direct recipients and managers of the transfers in the family group and act as promoters in the dissemination of activities and supervision of operations locally, all of which contributes substantially to gender empowerment.<sup>17</sup>

The population covered by these programmes and their funding levels relative to GDP are shown in the last two columns of table V.4. Two major programmes are “Bolsa Familia” in Brazil and “Oportunidades” in Mexico, both of which cover a large percentage of the population (16% and 25% respectively). These programmes are particularly important because they operate in the region’s most heavily populated countries. Programmes implemented in Chile, Colombia and Jamaica also have wide coverage, ranging from 4% to 9% of the population. Neither of these programmes’ budgets exceeds 0.35% of GDP. In fact, at 0.32% of GDP in both cases, “Oportunidades” in Mexico and the Programme for Advancement through Health and Education (PATH) in Jamaica represent the largest budgetary allocations.

## Evaluation and results

One of the factors contributing to the widespread use of conditional transfer programmes in the region is the availability of independent evaluations of their impact.<sup>18</sup> Research conducted on these programmes has made it possible to compare their basic assumptions, identify unexpected effects and examine implementation processes and their repercussions on beneficiaries’ living standards. It has also helped to make the programmes’ management more transparent and enhance their legitimacy in the eyes of the public. Table V.5 summarizes the effects identified in six of the main programmes undertaken in the region in the areas of education, health, nutrition, targeting and monetary incomes.<sup>19</sup>

The conclusions reached concerning the impact of conditional transfer programmes, summarized in table V.5, indicate that they have made a significant contribution to human capital accumulation. There is too little information, however, to support the conclusion that they might be more effective than similar programmes that do not include conditionality (see box V.3).

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<sup>17</sup> See the section on the multidimensional nature of poverty and programme diversity.

<sup>18</sup> This is a substantial difference with respect to other interventions that normally restrict themselves to providing accounting data on the use of physical and financial resources.

<sup>19</sup> Villatoro (2005), Aedo (2005) and Serrano (2005) provide more detailed information on these evaluations.

Table V.5  
EFFECT AND TARGETING OF CONDITIONAL TRANSFER PROGRAMMES

| Dimension                              | Oportunidades (Mexico)   | Red de Protección Social (Nicaragua)  | PRAF (Honduras)  | Familias en Acción (Colombia)   | “Bolsa Escola” (Brazil)     | PETI (Brazil)  |
|--|--|---|--|---|-----------------------------|--|
| School enrolment                       | ++ rural secondary, short-term, less in primary, greater among girls<br>+ urban, but no effect on girls<br>++ primary-secondary transition   | ++ enrolment rates, same for boys and girls, greater among poorer and younger families  | = little effect  | + enrolment rate among children between 14 and 17 years of age in initial areas   |                             |  |
| School attendance                      | = no significant short-term increase in rural areas  | + less pronounced   |  | ++ children between 12 and 17 years of age, rural and urban   |                             |  |
| Grade promotion                        | ++ rural children medium-term timely grade promotion: 38%-64% of boys<br>30%-39% of girls.<br>Between 0.66-1.12 years more education in rural areas; 0.12-0.2 in urban areas   | ++ School promotion rates, especially older children<br>0.9 years more education  |  |   |                             |  |
| Learning                               | = rural short term<br>+ medium term (indications)  |   |  |   |                             |  |
| Child labour                           | + (reduction) participation by rural children, but less than enrolment (short term)<br>++ urban (19 to 20 years of age, boys)<br>++ rural boys (medium term)<br>= rural girls (medium term)  | + (reduction) 5% children 7-13 years  |  | = no effect detected (but yes in terms of mothers' labour supply, although not significant)   | = no effect detected        | ++ (reduction) in some states (26% in Bahia)<br>+ (reduction) work in high risk activities |
| Health check-ups, prevention, diseases | ++ use of rural ambulatory health services<br>+ pregnancies with rural prenatal care<br>= births attended by doctors<br>+ levels of immunization<br>+ knowledge and use of family planning methods (rural)<br>+ (reduction) 20% days' illness children 0-5 and adults<br>16%-49% | ++ levels of immunization by 30%<br>+ nutritional checkups<br>+ growth check-ups<br>+ iron supplement but no reduction in anaemia | ++ prenatal care and child check-ups<br>= post-natal check-ups for mothers<br>+ immunization | ++ children under four years of age up to date with preventive check-ups<br>= over four years<br>++ (reduction) diarrhoea among rural children 0-4 years<br>= children over four years, urban areas |                             |  |
| Nutrition                              | + higher intake of calorie- and protein-rich foods, more varied diet (Discussion groups)<br>= 50% children 6-23 months taking the nutritional supplement provided  | + higher intake of calorie- and protein-rich foods, more varied diet  | = no evidence of nutritional effect, high levels of iron deficiency and anaemia              | ++ expenditure on food in rural areas<br>+ nutritional situation 0-6 years of age (weight) but no improvement in malnutrition   |                             |  |
| Monetary incomes                       | + (reduction) incidence of poverty 11.7%   | + avoided drop resulting from coffee crisis   |  |   | + (reduction) poverty by 1% |  |
| Targeting                              | 39.5% on the poorest 20%; 62.4% on the poorest 40%   | 55% on the poorest 20%; 80.9% on the poorest 40%  | 42.5% on the poorest 20%; 79.5% on the poorest 40%   | 71% on indigent families, 97.5% on poor families  |                             |  |

**Source:** Pablo Villatoro, “Los nuevos programas de protección social asistencial en América Latina y el Caribe”, working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished; and Cristián Aedo, “Evaluación del impacto”, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

**Note:** ++ significant effect; + minor effect; = no effect (statistically significant).

## Box V.3

**EFFECTIVENESS OF CONDITIONALITY AND THE SOCIAL RETURN OF SELECTED CONDITIONAL TRANSFER PROGRAMMES**

Although a key feature of the design of these programmes should be the comparison between conditional monetary transfers and those delivered unconditionally to beneficiaries, this issue has not yet been systematically evaluated. Bourguignon, Leite and Ferreira (2002) studied the “Bolsa Escola” programme in Brazil, and reached the conclusion that the imposition of conditions played a major role in eliciting decisions to send children to school. Without the conditionality, the authors conclude that the proportions of children in different occupational categories (school, child labour, school/child labour) would be virtually identical to what they would have been without the programme. In contrast, the conditional transfers, despite their low value, persuaded the families of 4 out of every 10 non-enrolled children to accept the incentives and send them to school. In relative terms, the conditionality reduced the proportion of children not enrolled in school from 6% to 3.7%. In contrast, other studies have found that in middle-income countries where high poverty rates coexist with high levels of early education coverage, the potential effect of conditional transfers on educational human capital is small. A study by Reiners, Da Silva and Trevino (2005) concludes that only 11% of beneficiary children in the “Oportunidades” programme attended school as a result of the transfer, and 65% of the families that received a transfer would have sent their children to school anyway.

In terms of the social return on this type of programme, Morley and Coady (2003) describe a simulation undertaken to estimate the cost-benefit ratio of these programmes and their internal rate of return using data from the “Oportunidades” programme in Mexico and the Red de Protección Social (RPS) programme in Nicaragua. This study calculates the total benefit for programme participants as the sum of the direct transfers received by the families, plus the present value of future monetary benefits arising from the additional years children spend in school (using a discount rate of 6%), minus the income “loss” associated with the programme (due to the reduction in child labour) and the private cost of schooling (school attendance, school materials and other items). Management costs and targeting errors are also factored into this calculation. The study considered the short-term effect of the programme in rural areas, estimating it as equivalent to an additional 0.66 years of schooling in “Oportunidades” and 0.9 years in RPS. The results yield internal rates of return of 8.9% and 11%, respectively. In neither case were the benefits of short-term poverty alleviation taken into account.

Exercises of this type need to be interpreted with caution. Among other issues, it has not been clearly demonstrated that additional years of schooling necessarily translate into higher wages; nor has account been taken of the schools’ capacity to offer quality education to new students. There are two reasons for this. First, educational achievement is only one dimension of the changes in human capital needed for people to improve their living standards. Productivity increases basically depend on the strengthening of cognitive abilities, rather than additional years of schooling; furthermore, the effects of these programmes in terms of learning outcomes have not been conclusively documented (Reiners, Da Silva and Trevino, 2005). Lastly, many of the region’s economies are not currently creating enough jobs to absorb a significant percentage of the poor, even if they were better educated. This highlights both the partial nature of the analysis and the importance of complementing these programmes with measures to boost the productive capacity of the economy.

**Source:** Pablo Villatoro, “Los nuevos programas de protección social asistencial en América Latina y el Caribe”, working document, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

Evaluations have shown that conditional transfer programmes have a positive educational impact, in both the short and the medium terms, as measured by indicators such as school enrolment and attendance rates, grade promotion and increased levels of schooling. Favourable effects have also been noted in terms of reducing child labour, albeit to a lesser extent. Nonetheless, in the only programme for which there is evidence on learning outcomes (“Oportunidades”), the results are more limited. In terms of distribution, the effects seem to be greater among men than women, and the impact of education on accumulated human capital tends to be conditioned by school system coverage prior to programme application (Villatoro, 2005).

The effect of these programmes in terms of health and nutrition outcomes is also generally positive, with significant increases in preventive health check-ups, access to health services and the use of out-patient services. Evaluations show that these effects are greater among infants and young children. As an indication of the participating families’ response in terms of prevention and treatment of children’s health problems, it may be noted that the “Oportunidades” programme expanded the dissemination and use of family planning methods (Hernández and others, 2005). On

the nutrition front, studies report a higher intake of calorie- and protein-rich foods and a more varied diet among the beneficiaries of the Oportunidades, Familias en Acción and Red de Protección Social (RPS) programmes (Attanasio and others, 2005; IFPRI, 2002; Skoufias and McClafferty, 2001). Evaluations have also identified areas in which programmes were not achieving the expected results, as in the case of the provision of micronutrient-fortified foods to highly vulnerable groups such as infants and pregnant women (Villatoro, 2005).

In most of these programmes, monetary transfers have boosted household income, although the transfers have not always been large enough to make a significant impact on the poverty rate. Monetary assistance has also served to cushion the impact of economic disturbances. In the pilot phase of Nicaragua's RPS programme, the beneficiaries' income remained unchanged, but there was a significant decrease in the incomes of families in the comparison group owing to the economic crisis (slump in coffee prices) that affected the areas where the programme was applied (IFPRI, 2002).

Most of the conditional transfer programmes aim to give broad coverage to population groups living in poverty, but they have also succeeded in targeting the poorest households. As table V.5 shows, the bulk of the benefits are received by the two poorest quintiles of the relevant populations, although there is a great deal of room for improving coverage in the first quintile.

In more general terms, major efforts have been made to achieve intersectoral integration, although several programmes have had problems in coordinating their work with education- and health-service providers (Rawlings, 2005). To address these difficulties, some programmes have created intersectoral coordination bodies at various levels.<sup>20</sup> Another distinctive feature of these programmes is their low management cost (Serrano, 2005).<sup>21</sup> Nonetheless, the conditionality of benefits can have counterproductive effects not envisaged at the programme design stage which can have negative repercussions on family well-being. These kinds of effects may arise as a consequence of a lack of knowledge, problems in making the rules of the operation known, or the use of unduly strict conditions. For example, the evaluation of the "Bolsa Alimentação" programme implemented in four north-eastern communities in Brazil found that, six months into the programme, the beneficiary children had put on less weight per month than the comparison group. This was attributed to the fact that mothers were afraid that they would lose the benefit if their children put on weight, believing that their presence in the programme was because their children weighed less than normal (Villatoro, 2005; Morris and others, 2004). A similar case arose in the pilot phase of RPS, in which families would become ineligible for monetary transfers if their children lost weight. This resulted in children being overfed before their check-ups at primary health-care centres. Although the requirement was later eliminated, many beneficiaries continued to display this type of behaviour (IFPRI, 2005). While this phenomenon has not been systematically studied in programme evaluations, the scant evidence available suggests that the use of conditionality as an intervention tool needs to be carefully evaluated.

In addition to the availability of independent evaluations, another very important aspect of the conditional transfer programmes implemented in the region is the stronger institutional framework in which their design and application have been set. Both "Oportunidades" and "Bolsa Familia" (the region's two largest conditional transfer programmes) are examples of the consolidation of scattered initiatives as the result of a political consensus to create institutions with enough power to coordinate these efforts.<sup>22</sup> Apart from the conditionality of transfers, institution-

<sup>20</sup> The experience of local committees in RPS Nicaragua shows that these mechanisms were important for expanding supply to meet rising demand for education and health services (IFPRI, 2002).

<sup>21</sup> Evaluations of the "Progresas" programme showed that of every 100 Mexican pesos allocated to the programme, 8.9 were absorbed by administrative expenses—a relatively low level of overhead compared to other social programmes. The largest components were the cost of selecting households (30%), followed by the cost of conditioning the receipt of transfers (26%) (Aedo, 2005).

<sup>22</sup> "Progresas", later replaced by "Oportunidades" represent the continuation of a variety of education and food subsidy programmes, and reflects the institutional strength developed by the Secretariat of Social Development and the political consensus achieved following the 1995 crisis. "Bolsa Familia" consolidates several separate initiatives ("Bolsa Escola," "Bolsa Alimentação," "Cartão

building is clearly one of the key factors in the relative success and broad coverage achieved by these programmes.

## Future challenges

This section describes a number of the challenges facing social initiatives in the region, particularly those belonging to the new generation of conditional transfer programmes. These challenges revolve around problems in the relationship between rights and obligations, empowerment of women, promotion of citizen participation and development of social capital, as well as the need to match the supply of services with the demand for them and to expand opportunities for beneficiaries to enter the labour market.

### Rights and obligations

Citizenship involves a relationship between rights and obligations. The conditional access to certain benefits provided by these transfer programmes is therefore set within a framework of shared responsibility and complementarity between those rights and obligations. For children to fully exercise their right to education, parents need to prevent them from dropping out of school. In certain situations, the opportunity cost may force very poor families to withdraw their children from school and employ them in activities that contribute to the households' income. This problem needs to be addressed in order to strengthen parents' response capacity in relation to their children's entitlement to education. Conditional transfer programmes have positive effects in terms of both children's rights and parents' obligations in relation to those rights. Moreover, by encouraging beneficiaries to adopt a proactive attitude, conditional transfers make it possible to establish a relationship based on mutual responsibilities on the part of beneficiaries and the programmes.

This is clearly reflected in the positive findings of the impact evaluations made of the region's main conditional transfer programmes, which show that the establishment of simultaneous requirements in various areas of intervention provides effective incentives for families and encourages positive synergies. Conditionality can thus be interpreted as an incentive for the adoption of responsible attitudes in the long term. By partly neutralizing opportunity costs, conditional transfer programmes enable beneficiary families to clearly recognize the present value of human capital investments, especially in education, health and nutrition.

It is important, however, to make sure that the use of conditionality does not inadvertently have negative effects. Conditionality must be understood as one among various tools that are available in social policy design, and it should be evaluated in terms of its potential effect in each situation.

In order to progressively strengthen entitlement to rights, social programmes need to actively identify and incorporate eligible families, rather than merely waiting for those needing support to ask for it.<sup>23</sup> In many cases the target populations of social programmes have very weak links with the established institutional structure and scant contact with official information campaigns, which makes it unlikely that they will respond to public initiatives. A passive attitude on the part of the State allows programmes to be "captured" by people who are not necessarily those who need them most.

Moreover, in some conditional transfer programmes, defining groups and neighbourhoods as poor or extremely poor has the effect of reinforcing latent conflicts in the respective communities. This is because the demarcation of beneficiaries or areas of coverage does not always coincide with the perceptions held by the poorest people or with the geographic demarcations made by the beneficiaries themselves. Even in programmes involving more participatory features, the intervention

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Alimentação" and "Auxílio Gás"). Coordination measures have been adopted as part of this programme, including the development of a unified beneficiary register; and it forms a fundamental component of the Zero Hunger programme —this is one of the priorities of the Brazilian government, and a State Secretariat was specially created to manage it.

<sup>23</sup> At the same time, stigmatization of beneficiary families needs to be avoided.

unit is taken as given; and the diagnostic phase is not seen as in activity in which the community itself has anything to say (Arriagada and Miranda, 2005).

## Empowerment of women, citizen participation and social capital

Empowerment, participation and the promotion of social capital should be seen as both means and ends in programmes to support the poorest population sectors. In terms of means, they represent instruments that enhance programme effectiveness through synergies and better utilization of community assets. They also strengthen enforceability, accountability and transparency. As ends, they represent victories in the sphere of citizenship, as they engender empowerment, inclusion and a voice in public affairs for beneficiaries.

However, neither the community dimension nor the creation of social capital has been singled out as an explicit priority in conditional cash transfer programmes, and attempts to implement the social capital approach in the specific areas of management and design have not been entirely successful (Arriagada, Miranda and Pavez, 2004; Serrano, 2005; Sojo, 2003). In fact, a rigid definition of the family as the intervention unit ignores the relationship between the family and its immediate surroundings; this can deconstruct collective patterns of mutual assistance and give rise to competition and rivalry for the funds provided by the programme (Serrano, 2005).

### Empowerment of women

An initial element to be highlighted in conditional transfer programmes is the empowerment of women, both within the family and in the community. The chance for women to receive a monetary income, in their capacity as the direct recipients of transfers in conditional transfer programmes, enables them to change their passive or subordinate position within the family and play a more important role as providers, especially in terms of resource-allocation and expenditure decisions (Armas, 2004). This more active role leads to greater recognition of their position in the household and enhances their self-esteem and self-confidence (see box V.4).

Greater empowerment for women in the context of conditional cash transfer programmes has increased their workload, since they have had to meet programme requirements relating to their families and the promotion of community involvement. (Arriagada, Miranda and Pavez, 2004).<sup>24</sup> It is therefore uncertain to what extent the new obligations undertaken by women in relation to the education, health and nutrition of their children, in exchange for the benefits of conditional transfer programmes, add to their pre-existing domestic workload and restrict their chances of gaining autonomy through participation in the labour market. Moreover, many programmes view domestic chores as a natural component of women's role and thus require counterpart contributions from them outside the home, without considering the cost of having their domestic functions undertaken by others (Kessler and Roggi, 2005).

Possible undesired effects include the emergence of conflicts between spouses, since many men react negatively to women having greater financial decision-making power or to their spending more time outside the home in activities related to counterpart contributions.

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<sup>24</sup> Greater empowerment of women needs to be complemented by a more equitable distribution within the home of tasks relating to obligations arising from social programmes.

## Box V.4

**EMPOWERMENT OF WOMEN IN CONDITIONAL TRANSFER PROGRAMMES**

Research undertaken in “Oportunidades”, the child-labour eradication programme (PETI), “Beca Escola” and “Bono Solidario” has found that mothers involved in these programmes have shown signs of increased psychological empowerment (Zimmerman, 2005) and that this has been reflected in greater self-confidence, higher self-esteem and greater “mental openness” (Armas, 2004; Adato and others, 2000; IFPRI, 2005). In “Oportunidades”, the training component has also had major effects, as the women indicate that their knowledge of nutrition and disease prevention has increased as a result of participation in the programme (Arriagada, Miranda and Pavez, 2004; Adato and others, 2000).

The studies also found, however, that their participation led to tension within the family. Women involved in “Oportunidades” report, for example, that the programme takes up too much of their time, both because of the need to participate in activities and because they must take on the extra workload of tasks that were previously performed by their children (Adato and others, 2000). In that same programme, it was noted that some men were unhappy about the amount of time the women spent outside the home as promoters, a situation that created conflicts and break-ups. In any event, there was also solidarity among women to reverse the effects of these reactions on the part of some of the men (Adato and others, 2000; González de la Rocha and Escobar, 2002).

Information relating to impacts on decision-making patterns within the family tends to confirm this. For example, mothers participating in the “Bono Solidario” programme in Ecuador found it difficult to convert the transfers into decision-making capacity within the family (Armas, 2004). In “Oportunidades”, only limited changes in decision-making patterns were observed; beneficiaries and non-beneficiaries alike said that women made decisions on food expenditure, while men decided on larger items. The situation was more pronounced in the case of men with less education and those of indigenous origin (Adato and others, 2000).

Lastly, the evidence regarding the short-term effects of making transfer payments only to mothers on the quality of family relations is inconclusive. Some mothers participating in “Oportunidades” stated that their spouses were giving them less money since the start of the programme. Key informants claimed that, in some cases, transfers were being appropriated by men (Adato and others, 2000; González de la Rocha, 2003). Some female beneficiaries of the “Bono Solidario” programme had to develop strategies to manage the money and prevent their spouses from keeping it. Women participating in this programme have said that their partners have used violence to take the transfer from them in some cases (Armas, 2004). In contrast, in the evaluation of the RPS social protection network in Nicaragua, there were no reports of mistreatment or domestic violence linked to participation in the programme; on the contrary, the availability of extra resources was viewed as producing positive effects, such as reduced conflict and improved family relationships (IFPRI, 2005).

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

**Citizen participation**

Citizen participation in programme monitoring is an essential element in several respects. First, it enables beneficiaries to make sure that they actually receive the services offered in the programme, since it opens up their access to authorities and programme managers and provides them with the information they need to evaluate the latter’s effective compliance. By the same token, it strengthens beneficiaries’ awareness of their rights. Second, participation translates into greater beneficiary involvement and dialogue; in other words, it gives greater “voice” to people who have traditionally lacked access to decision-making mechanisms. This aspect is very important because it combines enhanced social rights (through access to programme payments and benefits) with strengthened political citizenship. A social learning effect is engendered among poor groups in the population that makes it possible to reverse the vicious circle created by a lack of power and resources and to replace it with a virtuous circle of greater empowerment and increased capacity to demand resources and transfers. Third, citizen participation is positive in that it inevitably leads to greater transparency and accountability in public affairs, thereby reducing mismanagement, corruption and abuse. In this regard, several of the conditional transfer programmes applied in the region have incorporated a number of oversight and monitoring mechanisms to encourage citizen participation, increase transparency and avoid any diversion of resources away from the poorest

communities. Schemes of this type include community mechanisms for validating beneficiaries in the “Oportunidades” (Mexico) and Bolsa Escola (Brazil) programmes.<sup>25</sup>

Citizen participation not only leads to better management of social programmes, but also encourages civil society involvement in the design and execution of activities (especially adaptation to the local environment and the cultural heterogeneity of the beneficiaries), allocation of resources and definition of priorities. Greater participation helps enrich social programmes by disseminating the social learning that is spread throughout the community. Veins of innovation present in civil society, which usually emerge on a local and community scale, can be “mined” by social programmes to create synergies between public initiatives and the creativity and innovation arising from the community. The opening of participation channels thus facilitates the capitalization of social innovation through public policies (see box V.5).

#### Box V.5

### SOCIAL INNOVATION IN CIVIL SOCIETY: A RECENT RECORD

With support from the W.K. Kellogg Foundation, ECLAC is implementing a project entitled “Experiences in Social Innovation in Latin America and the Caribbean”. The aim of this project is to identify, analyse, disseminate, and acknowledge innovative programmes in the region, whose main purpose is to promote the common good by creating conditions conducive to the development and strengthening of citizen participation, especially in disadvantaged communities or groups.

ECLAC and the W.K. Kellogg Foundation award prizes to programmes which have introduced innovative processes, practices and approaches resulting in qualitative or quantitative changes in commonly used practices; that have a positive effect on the beneficiaries’ quality of life; that help expand or consolidate the principles of true citizenship; that can be replicated in other population groups or countries; and that are sustainable. The programmes target the areas of education, health, food security, nutrition, rural development, income generation, social responsibility, volunteer action, and youth.

Notable examples of the many innovative activities identified by this project include: a programme introduced in Brazil to reduce child mortality using key community informants and promoters responsible for maintaining epidemiological records, together with a register for monitoring expectant mothers and children at risk; health programmes implemented in Chile and Colombia to strengthen indigenous medical systems within the same therapeutic frameworks as Western medicine; an educational rotation project for the third cycle of general basic education in rural areas of Argentina which incorporates non-traditional teaching methods in agricultural schools; and a community network to produce and distribute dairy products to cover nutritional deficiencies in Haiti.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

### Social capital

Including the promotion of social capital as an aspect of poverty reduction programmes can foster greater social inclusion, since it involves paying special attention to the networks that link poor sectors to each other and to other sectors of the population. The specific aim is to alter the scope of social networks and the degree of association between groups with different types of social capital. It also involves stressing the role of social relationships of trust, reciprocity and cooperation in sustaining community initiatives and in poverty mitigation strategies. Another reason for including the development of social capital in such programmes is to encourage participants to play a more active role in solving their own problems.

Incorporating a social capital component in poverty reduction programmes places priority on the social relations existing in the community and on participation in decision-making by members of the community. Even when there is an awareness of the organizational structures of the target

<sup>25</sup> In the emergency programmes executed in the region, different forms of participation have been developed, such as the local and provincial emergency councils set up under the “Trabajar” plan in Argentina. This model was also applied to the local consultative councils of “Jefes y Jefas” (Argentina), and to the round tables and assemblies of PESP and “A Trabajar” (Peru). Although there is no systematic evidence on the effect of this type of initiative, the incorporation of citizen participation and oversight mechanisms in the “Jefes y Jefas” programme in Argentina proved more efficient in reducing political and social conflict than in the specific management of the programme (Villatoro, 2005).

communities, however, if the programme ignores the dynamics of the community and its self-management processes (which are recorded in its historical memory and in its tradition of collaborative activities), it will be impossible to achieve this. The same holds true if the programme focuses on providing certain services, but the planning of the successive stages fails to take account of the community's specific characteristics and past history, pre-existing networks and positive leadership roles.

From the standpoint of the synergies that anti-poverty interventions seek to achieve, the fact that social capital is an intangible asset that opens up access to other resources must be taken into consideration. As such, it has value in itself, for reasons which include the sense of belonging and inclusion that it can give to people and the power that can be derived from the simple fact of organizing and relating to others. Nonetheless, many analysts insist that the main value of social capital is that it facilitates access to other resources (Arriagada and Miranda, 2005). To promote social capital development within the framework of social programmes, simultaneous consideration needs to be given to technical and methodological issues (the system for providing goods and services, the role of intermediaries and modes of beneficiary participation, among others) and to the project design, its institutional setting and its management. Ways of doing things, the agreements that are made and shared responsibilities underpin the sustainability of processes relating to social capital.

To strengthen community organization and create or expand social capital, programmes should include the following components: (i) a baseline analysis of the predominant dynamics of cooperation and conflict, both inside communities and between them and social institutions; (ii) definition of the projected effects in terms of social capital; (iii) methodological tools for strengthening identity, association and local leadership; (iv) consideration of the role of promoters as it relates to their ties to the area, the horizontal nature of the work they undertake and their experience in development activities; and (v) institution-building (Arriagada, Miranda and Pavez, 2004).<sup>26</sup>

### Coordinating the supply and demand for services

Social programmes that are based on stimulating the demand for services (education and health, among others) need to be coordinated with their supply, since the region's poor have less access to the infrastructure and network of government services. Consequently, if beneficiary rights and obligations are established, supply needs to be guaranteed in both qualitative and quantitative terms in order for those rights and obligations to be enforced.

Given the requirements established by some programmes in terms of school attendance, medical and nutritional check-ups, and participation in information sessions on public health issues, among other things, these programmes need to have a network of schools, health centres and trained professional staff to provide the corresponding services. Steps therefore need to be taken to make sure that the relevant services are available and accessible. Programmes must also have the necessary budgetary and administrative resources to strengthen areas in which shortcomings are identified. This type of intervention also requires a degree of intersectoral coordination that is not always explicitly factored into social programmes.

A wide range of activities have been undertaken in recent years to complement demand incentives with improvements in the provision of the relevant services. One example in this regard is Nicaragua's RPS social protection network, which includes elements for developing education and health services. Nonetheless, this aspect must also be integrated into the organization and

<sup>26</sup> In emphasizing social capital development and fostering community organization, one cannot ignore the traditional patterns of application and political appropriation of social policy, which can turn local organizations into tools of political legitimization for the government of the day. This is what happened with the National Solidarity Programme (PRONASOL) in Mexico (a predecessor of "Oportunidades"), whose mode of operation through solidarity committees resulted in the definition of social demand being dominated by group of intermediaries, the inflation of social claims by demands for various social rights of indeterminate magnitude at the negotiation table, and the subordinate integration of social organizations with the State. Some analysts hold that this programme also fostered exclusive capture of the benefits by non-corporate social segments, as well as a popular culture based on clientelism and passivity (Villatoro 2005).

budgets of all social programmes that have intersectoral coordination mechanisms in order to ensure the availability of suitable, high-quality services. There are various institutional arrangements for intersectoral coordination in the region, ranging from the establishment of social cabinets and coordination via networks to the creation of a coordinating agency for all social projects. Examples include Chile Solidario, Red de Protección Social (Colombia), Programa de Protección Social (Ecuador), Red de Protección y Promoción Social (Paraguay) and Bolsa Familia (Brazil). Each approach has advantages and disadvantages that need to be analysed in the light of the circumstances in each country. What is important is the structure of the coordination system, its permanency through time and the powers actually given to it, since the mere creation of a high-level mechanism does not in itself guarantee sectoral coordination or subordination of the various stakeholders to an integrated view of the effort to combat poverty (Machinea, 2005b). Events in this field over the past few years have shown that information technologies can make a valuable contribution, especially in beneficiary selection but also, increasingly, in the coordination of social programmes and the interoperability of State institutions (see box V.6).

#### Box V.6

### BENEFICIARY IDENTIFICATION AND THE USE OF INFORMATION AND COMMUNICATIONS TECHNOLOGIES (ICTs)

The adoption of targeting criteria and the need for standardized and objective tools to measure poverty and vulnerability when assigning benefits, together with indicators for programme evaluation and monitoring, has been a major challenge that most of the countries studied have addressed to prevent social programmes from being used for political clientelism, and to make them more effective. Several pioneering activities should be mentioned in this context: the national socioeconomic survey (CASEN) and the CAS card (to be replaced by its successor, the family card) in Chile; the complete system of indicators of the Planning Department and the national information system on social programme beneficiaries in Colombia (SISBEN); records of the social programme information, monitoring and evaluation system (SIEMPRO) of the system for identification and registration of beneficiary families of social programmes and services (SISFAM) in Argentina; and more recently, the preparation of a single beneficiary register that cross-references national, provincial and municipal data in the framework of the federal social policy network, and the information system for social action (SIPAS) of Costa Rica.

Intensive ICT-use is a key element of these systems, particularly in two aspects of their administration: beneficiary targeting and identification; and coordination, both sectoral and geographical, in programme implementation. The adoption of ICTs in Latin America and the Caribbean has been gradual, starting in the 1990s when computer programmes were introduced in the administration of government agencies. It was then extended to the provision of information and a number of online procedures through Internet portals in the first half of this decade, together with technological interoperability between government agencies. Its main contributions in the area of social protection policy can be classified in the following five categories:

**Remote access** through technological media, which makes it possible to apply for social programme benefits from places where the government agencies responsible for providing them have no representation. It also facilitates data and document transmission between government agencies.

**Management of databases** with equal standards, allowing for the entry, storage, updating and transmission of social data between state agencies, to verify, inspect and share data automatically, without citizens having to request and provide them personally in the relevant government office.

**Interoperability** of the government agencies involved in social protection programmes, through formal agreements for technological linkage in the interfaces where they operate, among other areas in making legal agreements official, at technical, semantic and institutional levels. Although not very complex, these are fundamental for coordination through technological media.

**Technological infrastructure**, understood as the incorporation of hardware, software and telecommunications networks, along with other media that facilitate remote access, interoperability and exchange of databases.

**Crosscutting issues**, including those that highlight the need for legislative and regulatory changes to provide the services envisaged in programmes through technological media, together with technical training and financing, all of which is needed for computerization of a more coherent public sector and effective interoperability.

Several countries offer interesting examples of the use of ICTs in social protection programmes. Many of their activities have won awards for their use of innovative methods, having improved the quality of services provided to beneficiaries, and having increased management effectiveness; and they represent integrating strategies for social protection programmes, for whose effective application ICT use is essential.

**Source:** Álvaro Vásquez, “Ejemplos de uso de tecnologías de información y comunicación en programas de protección social en América Latina”, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

Coordination between demand incentives and the availability of services should not be solely quantitative; special emphasis also needs to be placed on service quality and inclusiveness. The most disadvantaged groups require interventions designed to take their characteristics and needs into consideration, since a homogeneous supply in heterogeneous situations will only perpetuate the original differences that run counter to the principle of equity (Cohen and Franco, 2005). For example, if school attendance by boys and girls from families at social risk is to be increased, then the school system needs to pay special attention to these new pupils, given the multiple disadvantages that poverty and marginality tend to involve. In fact, one of the main shortcomings of conditional transfer programmes is that, despite the expansion of assistance, beneficiary children only achieve moderate improvements in their school performance, as noted in the case of “Oportunidades”. Heterogeneity in the supply of services must translate into improved adaptation to the situation of the persons generating the demand for those services without aggravating segmentation in the quality of supply.

Another dimension that needs to be considered in the coordination of social programmes is the interrelationship between short- and long-term goals in the framework of employment-related emergency programmes. It is important for these programmes to succeed in harmonizing short-term job creation with the development of long-term productive capacities.

Finally, the coordination of social programmes in the effort to combat poverty should not be limited to health and education services. It is also important to build bridges between these areas and other spheres of government activity, and particularly with public policies on infrastructure, housing, drinking water, sanitation and transport.

### Productivity and employability

By raising individual productive capacities, human capital development is one of the keys to reducing future inequalities and overcoming the intergenerational reproduction of poverty. Nonetheless, the effects of conditional transfer programmes on the future of today’s children cannot be fully evaluated, since that future will depend not only on human capital accumulation, but also on the employment opportunities they find once they have left the programme. An expansion of productive opportunities for the poor is not guaranteed, however, because the region’s economies face serious difficulties in creating decent jobs.

These difficulties are reflected both in the economic structure<sup>27</sup> and in recent trends and events in the region. As noted in chapter II, the region’s economy has endured major crises and a high degree of volatility over the last two decades which have resulted in slow growth rates and high unemployment, among other negative consequences. During this period the growth rate has barely outpaced that of the labour force, and on several occasions the investment rate has dipped below 20% of GDP, which is insufficient to overcome poverty (ECLAC, 1996).

Consequently, efforts to upgrade education, health services and nutritional levels through social programmes need to be complemented with production policies that elicit a greater supply of decent jobs; this, in turn, means that steps have to be taken to strengthen productive development. ECLAC has undertaken indepth analyses of policies for improving economic performance on a number of occasions, particularly at its most recent session, held in Puerto Rico in June-July 2004 (ECLAC, 2004b). Special mention should be made in this connection of policies designed to help strengthen microenterprises and small businesses, which are an important complement to poverty reduction strategies, especially since roughly two thirds of all new jobs created in the region in the 1990s were in the informal sector (ECLAC, 2004b).

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<sup>27</sup> In the framework of changing production patterns with social equity, ECLAC recognizes the important interaction that exists between an economy’s productive apparatus and employment opportunities for its labour force. Its main manifestation has been heterogeneity in terms of productivity, economies of scale and market access with which productive units can operate. Historically, this heterogeneity has been reflected in labour-market segmentation, where low-productivity segments in an informal sector characterized by self-employment and precarious conditions coexist with high-productivity sectors offering formal, protected jobs (ECLAC, 1990).

The modernization of microenterprises and small businesses helps to raise the systemic productivity of the economy and strengthens the production base that underpins the well-being of low-income groups. Support strategies for small enterprises should include the provision of financing for their business activities, access to relevant information on their production processes, and incentives to formalize their activities; they should also combine horizontal and selective policies. Horizontal policies should include measures to improve access to information, credit, technology and marketing systems, along with actions aimed at simplifying rules and procedures, reducing the tax burden and, especially in the rural sector, regularizing land titles among small-scale producers. Selective policies range from the establishment of small-business associations, to the strengthening of networks between large firms and their SME suppliers or customers. As an example, market access can be promoted through inter-firm coordination (e.g., by setting up SME exporter groups). Another possible field of action involves strengthening geographically based production clusters or enclaves, or their coordination as links in a value chain. Infrastructure improvement is particularly important in rural areas, along with the enhancement of competitiveness through partnerships for the purchase of technology and marketing services (Machinea and Hopenhayn, 2005). Although both types of policies are already being applied in several countries, their coverage needs to be expanded; monitoring and participation mechanisms also need to be adopted, and their design improved (ECLAC, 2004b; Machinea and Hopenhayn, 2005).

Finally, production policies need to be backed up by macroeconomic policies to speed and stabilize growth and by an increased awareness that informality is not overcome in the short run. Formalization of the economy requires sustained growth and active policies to promote employment and productive modernization.



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