COVERAGE GAPS IN SOCIAL PROTECTION: WHAT ROLE FOR INSTITUTIONAL INNOVATIONS?

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January 2011

Paper prepared for the international conference on Social Cohesion and Development Paris 20-21 January 2011

Abstract

This paper examines some of the most popular institutional innovations in social protection from the past decades: conditional cash transfers, employment guarantees, social pensions and unemployment savings accounts. These and other policy instruments have contributed to expanding the coverage of social protection in developing countries. However, the coverage in insurance against certain risks remains very low even in the middle of the income distribution. Using the example of pension coverage in Latin America, this paper argues that instruments that better bridge social insurance and social assistance are needed in order to overcome the duality of social protection systems in middle-income countries.

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This paper draws heavily on recent work on two background papers undertaken for the *Latin American Economic Outlook 2011* and the *Perspectives on Global Development 2011*. "The Economy of the Possible: Pensions and Informality in Latin America" (with R. da Costa, E. Martinez and A. Melguizo) and "Born and Bread: Institutional Innovations for Social Protection in Developing Countries" (by P. Nagler).

The opinions expressed and arguments employed in this document are the sole responsibility of the author and do not necessarily reflect those of the OECD or of the governments of its member countries.

INTRODUCTION

"Everyone, as a member of society, has the right to social security", states Article 22 of the Universal Declaration of Human Rights. And yet, this right to security, which encompasses "…the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control" (Article 25) remains a privilege.

More than 60 years after the adoption of the declaration, more than 80 per cent of the global population is not covered by social insurance that can guarantee such security. In most developed nations, social protection –in different flavours—contributes to maintaining the fabric of society. In many less developed nations, social security, whether publicly or privately provided remains the purview of civil servants and formal wage workers, who are often a minority.

Indeed, payroll-tax financed contributory social security exists in most countries, but the prevalence of informality generates a number of challenges in extending their coverage. As a result, the majority of the population remains outside their remit. Only 26.1% of the working-age population in sub-Saharan Africa have access to old-age coverage, 17.1% to protection against employment injury and a meagre 1.1% to unemployment insurance. Other developing regions have slightly higher levels of protection but are still considerably below the level of developed countries.

In response to these challenges, and in some cases spurred by the availability of greater fiscal space that has accompanied the past ten years of "Shifting Wealth", a number of countries have established social protection programmes based on new instruments. Their success has generated much attention among donors and policy makers in other Southern countries. They include, among others, anti-poverty measures such as conditional cash transfers or social pensions, tools to universalise health coverage through community-based health insurance or the establishment of national health services that interface with more traditional institutions.

This paper analyses some of these instruments and finds that they have indeed helped increase coverage dramatically. However, the paper also highlights that a substantial share of the working-age population has incomes that lie above the poverty line and works informally. This segment of the population is ill-served – if served at all—by social assistance instruments that do not make full use of their saving capability, while having limited access to the formal sector social security system.

A number of policy orientations can help fill this gap while consolidating the social protection system, so as to build a comprehensive and coherent welfare state. From universal coverage in some health or old age support to defined contribution pensions open to informal workers, experiences abound on individual instruments that contribute to closing the gap.

The remainder of this paper is organised as follows. In the next section, the gaps in social protection are exposed. These gaps differ by function of social security (old age, income support, health, etc…) and by country. The following section looks at a few innovations in social protection that have gained prominence in the past ten years. The fourth section examines whether, despite the advances in institutional innovations, there remains a missing middle in coverage and discusses policy options to address this. Finally, the concluding section underlines the importance of holistic and coherent approaches to social protection in forging the welfare states of the future for emerging and developing countries.

COVERAGE GAPS AND CHALLENGES IN DEVELOPING COUNTRIES

Most countries in the world have some form of contribution-based social insurance system. However, only a minority of countries have comprehensive social security systems[2] (ILO, 2010). Moreover, statutory contributory schemes in most countries only cover employees and (sometimes) their dependants. Self-employed workers sometimes have access to social security systems on a voluntary basis, resulting in low coverage rates.

The degree of informality is therefore a key determinant of the reach of contributory social insurance. Informality is here understood as the existence of a labour relationship that is neither recorded nor protected by the state, and therefore is understood to include self-employment as well as informal salaried employment, whether in formal or informal production units. Informal work is pervasive and, on average, covers 55 percent of non-agricultural work in developing countries (Jütting and de Laiglesia, 2009).

Figures 1 and 2 show levels of coverage for employment injury protection and old age pensions. These are selected because schemes against these two risks exist in the great majority of countries (ILO, 2010). Patterns in coverage are therefore isolated from the existence of cover schemes in the country unlike the case, for example of unemployment insurance.

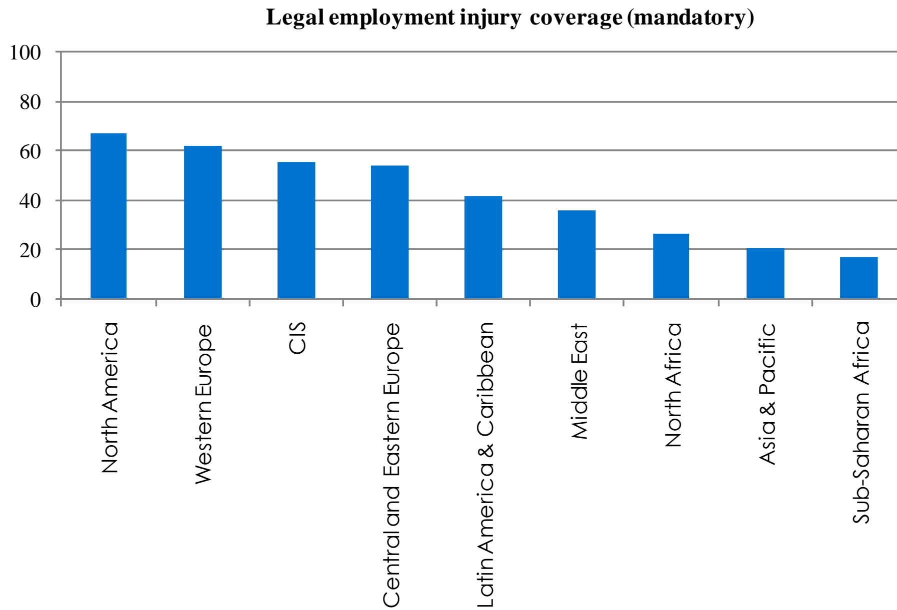
Levels of coverage follow the prevalence of "good quality" formal salaried employment across regions. Coverage is high in North America, Western Europe and ex-Soviet states where about 85 percent of workers are covered, but only reaches 30 to 40 percent in Latin America and the Middle East and is close to 20 percent in Asia and Sub-Saharan Africa.

In most countries, employment injury coverage is contribution-based and mandatory and therefore serves as a benchmark for coverage in other areas of social security. Patterns for old age pension coverage are slightly more complex, as beneficiaries have built up entitlements in the past.

[2] The International Labour Organization defines ten elements of social security coverage: medical care, sickness benefits, and protection of disability, old age, survivor, maternity, children, unemployment, employment injury and general protection against poverty and social exclusion (ILO, 2010).

Figure 1 - Legal employment injury coverage

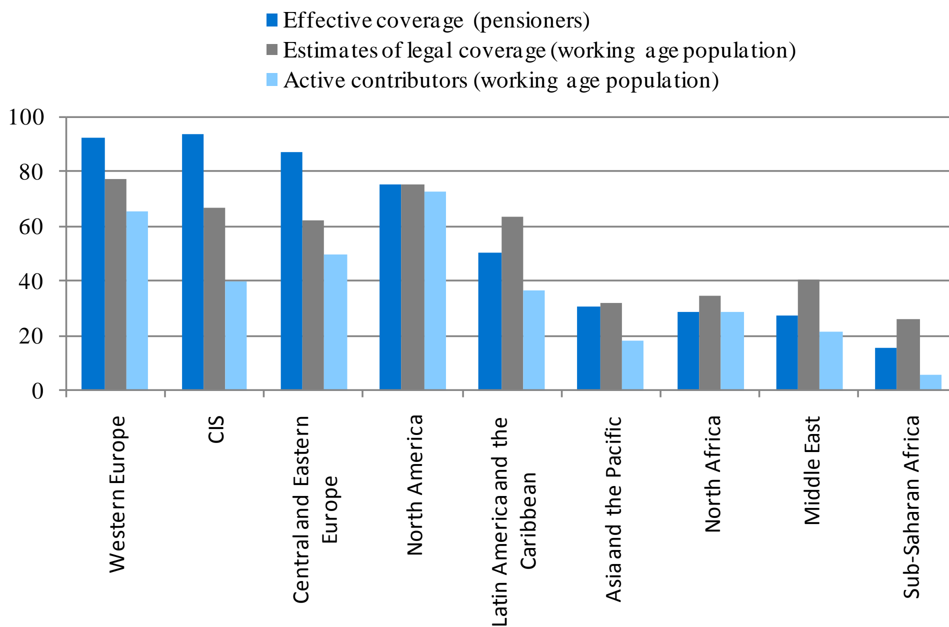
Share of the working age population (%)



Source: ILO (2010)

Figure 2 - Old age pension coverage

Shares of the relevant population (in parenthesis)



Source: ILO (2010)

Figure 2 shows first that in most regions with mature social security systems effective coverage outstrips both legal coverage and active contributors. In these countries, non-contributory social pensions complement or substitute for contribution-based pensions in many cases, leading to higher coverage rates than those implied by the contribution rates of the working age population.

Figure 2 also points to the existence of a dual coverage gap. The figure displays both the rate of workers contributing to the pension system and the legal coverage rate, which includes all workers statutorily included in the system. Not only is legal coverage relatively low in many developing countries, but in a number of regions, the contribution rate is significantly lower than the legal coverage rate. A number of countries in the CIS, Latin America and the Asia-Pacific region struggle to ensure contributions from those workers whose occupational category would entitle to participation.

Limited participation by entitled workers is a problem in ensuring coverage, as shown by the example of old age pensions. It also raises a major financing issue in systems based on intergenerational solidarity, because the weight borne by the active generation is disproportionately increased when contribution rates are low. Although most regions in the developing world are relatively young, ageing populations will contribute to questioning the sustainability of pension systems.

The prevalence of informal work generates multiple challenges in social protection. The role of informality in limiting the size of contribution-based social protection is well known and has been highlighted elsewhere (by the ILO (2010) among others). Informal workers are not covered, nor do they contribute to statutory contributive systems.

The prevalence of labour informality also limits the verifiability of work status. In a country with a large informal sector or where workers in formal enterprises are not systematically declared, it is difficult for the authorities to ascertain whether a worker is unemployed or working informally. This problem is compounded over time, so that for example pension eligibility is only based on formal work, limiting the proportion of the population that can access even certain non-contributory minimum pensions despite having worked for more than the minimum established.

Finally, labour incomes of most informal workers are not verifiable. Most social assistance benefits are means-tested, which would ideally require accurate and up-to-date information on household income. In formalised salaried labour markets, such information is readily available from employment records, social security reports or tax reports. When it is not available, other forms of means test need to be devised.

Informality is of course not the only obstacle in extending social protection. Financing is a key obstacle. However, ILO (2008) estimates show that basic social protection packages are affordable for all but the poorest countries in the world and would cost between 2 and 6 per cent of GDP. OECD countries invest much more heavily in social

security – generally over 20 per cent of GDP[3] – so the levels of expenditure for basic packages appear as affordable. However, this assumes that domestic resources can be mobilised, which is not true of all countries (OECD, 2010). Making fiscal space available is therefore a key challenge in establishing and maintaining social protection systems.

The capacity to deliver benefits and services is also limited, especially in the case of healthcare by the administrative capacity of individual administrations and by the development level of the health sector.

Nevertheless, informality compounds the above issues as it limits the ability of the state to collect taxes, both direct and indirect, and payroll contributions. Informality also generates uncertainties over entitlement and needs in in-kind benefits, including health care. For that reason, the institutional innovations are examined in their ability to respond first ant foremost to the shortfall in coverage.

[3] OECD Social Expenditure database.

REASONS FOR OPTIMISM: INSTITUTIONAL INNOVATIONS IN SOCIAL ASSISTANCE

The economic crisis of 2008/09 highlighted the vulnerability of populations across the world and put the extension of social safety nets firmly in the international policy agenda. Indeed, a number of fiscal stimulus packages enacted to contain the effects of the crisis and to prime the recovery contained social protection provisions, from Western Europe to China.

The rise to the front of social protection issues in both developing and developed countries is not merely a blip in the discourse. First, it responds to a series of momentous shifts in the global economy, which allow countries to finance the extension of social protection through greater fiscal space and also make social protection all the more necessary in the face of growing competition from international markets. Second, it has many concrete realisations both in the extension of established forms and in the implementation of new instruments of social protection

The "quiet revolution" of social protection in developing countries (Barrientos and Hulme, 2008) was in the making for over ten years. Indeed, the decade of the 2000s witnessed a quantum leap in social protection in the developing world. The main component of this change was the implementation of a number of new forms of social assistance, especially means-tested cash transfers.

The rapid introduction of means-tested cash transfers has greatly increased the scale of coverage of social protection. South Africa's Child Support Grant, introduced in 1998 covered 7.7 million children by 2008, China's Minimum Living Subsidy Scheme (*DiBao*) was introduced in 1997 and reached 57 million households by 2007. The very popular conditional cash transfer (CCT) programmes in Mexico (*Oportunidades*) and Brazil (*Bolsa Família*) reach respectively 5 and 12.5 million households or about a quarter of the population in each country[4] (Barrientos, Niño-Zarazúa and Maitrot, 2010).

Beyond issues of scale, the nature of social protection interventions in developing and emerging countries has been transformed dramatically in the past decade. Chief among institutional innovations are conditional cash transfers, dubbed by *The Economist* "the world's favourite anti-poverty device"[5]. Other institutional innovations include India's

[4] Admittedly, these examples are drawn from countries with large populations, but significant proportional extensions in coverage are documented for many smaller countries in the Social Assistance in Developing Countries Database (Barrientos, Niño-Zarazúa and Maitrot, 2010)

[5] "Give the poor money", *The Economist*, Jul 29th 2010.

National Employment Guarantee Scheme or the use of community-based health insurance as intermediaries to extend social health coverage in West Africa.

Most of these programmes and policies are social assistance interventions, in the sense that they are non-contributory, financed out of general taxation or donor funds and aim chiefly at supporting those in poverty or at risk of falling into poverty. As will be discussed in Section 3, this ensures better targeting but also limits the role of such instruments in a more comprehensive social protection system.

The remainder of this section presents some of the most innovative or influential programmes and policies in detail. It goes on to examine their characteristics to find commonalities and differences. Although these interventions are implemented in very different country contexts, a number of common elements emerge that have contributed to their expansion. These include their targeting performance, their relatively low administrative costs and their potential to alleviate poverty.

Conditional Cash Transfers

Conditional Cash Transfer (CCT) programmes transfer cash, generally to poor households, under the condition that those households make a set of pre-specified investments in human capital. These "conditionalities", as they are often referred to, differ from one programme to the next. Education conditions usually include school enrolment and attendance for children. Health conditions require regular checkups, vaccinations for children and perinatal care for mothers.

The pioneer programmes were implemented in Bangladesh, Mexico and Brazil, following the same model but with slightly different focus in objectives. In Bangladesh, the Female Secondary School Stipend Programme (FSSSP) aimed first at increasing girl's enrolment and retention in secondary school, and ultimately at delaying girls' marriage[6]. In Mexico, the *Programa de Educación, Salud y Alimentación* (PROGRESA, later renamed *Oportunidades*[7]) was launched in 1997. Initiated in the midst of the recovery from the deep recession that followed the 1994 peso crisis, PROGRESA had a wider set of human development objectives, including education, health and nutrition, as well as poverty reduction in the set of desired outcomes. In Brazil, the current CCT programme (*Bolsa Família*) was born of the consolidation of a number of similar programmes, the first of which had education as its main objective and had been implemented nationally in 2001.

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[6] The link between schooling and early marriage is complex and works both ways. Delaying marriage causes increased demand for schooling on the part of girls by 0.22 years of schooling per year of delay (Field and Ambrus, 2008).

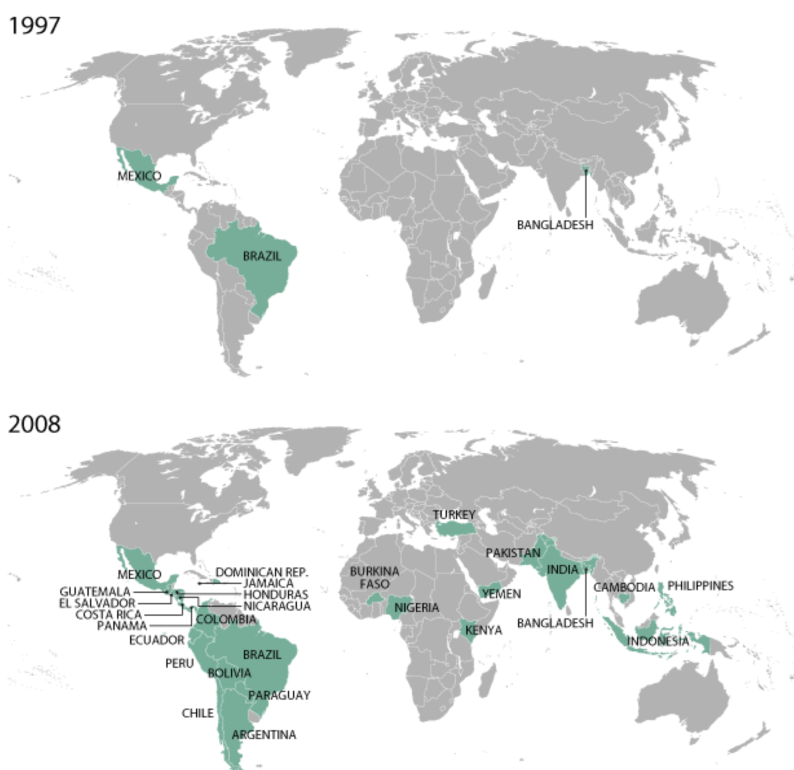
[7] This paper refers to the programme as PROGRESA when referring to evaluations carried out during the expansion phase of the programme as scale and institutional modifications may alter the external validity of impact assessments.

These original differences also led to differences in design. In Bangladesh, given the relatively narrow objective, the transfers are small – between 35 and 80 taka per month (Barrientos, Niño-Zarazúa and Maitrot, 2010) compared to the average hourly wage of 17 taka as revealed by the 2007 Bangladesh occupational Wage Survey (Kapsos, 2008). Moreover, the conditionalities are individual. Transfers are made conditional on 75 percent school attendance and a minimum performance cutoff as well as the beneficiary girl remaining unmarried. In Mexico and Brazil, transfers are larger and conditionalities cover the whole household, including maternal health visits.

Since the late 1990s pilot experiences, conditional cash transfer programmes have sprawled and, by 2008, 29 countries had a conditional cash transfer programme (Fiszbein and Shady, 2009). They include most Latin American countries, but also countries with such diverse social protection histories as Indonesia, Yemen, Turkey, Nigeria or Burkina Faso (Figure 1).

Figure 3

Conditional Cash Transfers in the World: 1997 and 2008



Source: Fiszbein and Schady (2009)

Many CCTs have a dual objective: alleviating current poverty while fostering investment in human capital among the poor in order to prevent the intergenerational transmission of poverty. The two objectives sometimes need to be balanced out: greater emphasis on poverty alleviation relative to human capital investment calls for larger

transfers and sometimes a more permissive attitude to the fulfilment of conditionality or to the means-test.[8]

The combination of means-testing and conditionality results in CCTs being successful in reaching the poor: on average 80 per cent of the benefits are channelled to beneficiaries in the two bottom income quintiles (Coady, Grosh and Hoddinott, 2004)

CCT programmes have been shown to be effective in reducing the severity of poverty and increasing schooling. PROGRESA/Oportunidades in particular received widespread academic attention, because the expansion of the programme followed a quasi-randomised process, allowing for the construction of control groups. Nevertheless ex-post findings are of similar magnitude.

For Mexico, Skoufias, Davis and de la Vega (2001) find a fall in the poverty headcount of 10 percent and of 30 per cent in the poverty gap. Using nationally representative data from Brazil, Soares and Sátyro (2009) find that *Bolsa Família* reduces the poverty headcount ratio by 8 per cent and the poverty gap by 18 per cent.

The results on current poverty seem modest but have to be put into perspective. The size of transfers in these programmes is typically small as it is only a fraction of the poverty line. In Oportunidades, transfers constitute a quarter of average household income of beneficiaries in rural areas and between 15 and 20 per cent in urban areas (Levy, 2006). In Brazil, Bolsa familia contributes 0.51 of total household income (Soares et al, 2007; Soares and Sátyro, 2009).

Given their coverage, CCTs in Mexico and Brazil contribute substantially to reducing income inequality. Soares et al (2007) find that, jointly, cash transfer programmes in Brazil were responsible for 28 per cent of the fall the Gini coefficient in Brazil between 1995 and 2004 of which 21 percentage points were accounted for by Bolsa Família.

The impact of CCTs on human capital has been more modest and is also more difficult to quantify precisely. Using data from Mexico, Skoufias (2005) finds that, assuming programme effects are sustained over time, accumulated effects of the programme increase average schooling by 0.66 years of education. In the Brazilian case, Schwartzmann (2005) finds that children enrolled in the CCT programme are much less likely not to be enrolled in school (by 10 percentage points) and also less likely to miss more than 5 days of school. However, absent the randomisation component, attributing these effects to the programme may be misleading. Cardoso and Portela Souza (2004) find that in Brazil transfers are too small to get children out of work altogether but do help tilt the allocation of time between work and school in the favour of the latter.

[8] In Brazil's *Bolsa Família* for example, a household needs to fail to comply with the conditions four times in order for benefits to be terminated. Household eligibility is updated only every two years.

Finally, it should be noted that these effects are achieved with relatively modest expense. Brazil and Mexico spend around 0.45 per cent of GDP in them, representing 2 percent of social spending in Brazil and 4.3. per cent in Mexico (Cecchini, 2009). Moreover, administrative costs are only 2.5 percent of total programme costs in Brazil and 2 per cent in Mexico.

Conditional cash transfer programmes have been very successful in middle-income countries and now exist in a number of low-income countries as well. Given the relatively small transfers which keeps them affordable and limits adverse labour incentives, these programmes are well-targeted and are well-performing tools to alleviate the severity of poverty.

Covering the working age population: Workfare and India's National Rural Employment Guarantee

Cash transfers both conditional and unconditional emerged as key components of the social protection system in many countries to respond to the vulnerability of specific groups. Conditional cash transfers aim especially at reducing the current and future vulnerability of children. Childcare and old age grants in Southern Africa have similar objectives, even though their effects go beyond these objectives[9].

Categorical targeting of the elderly or children helps make cash transfers politically and financially viable. However, they do not cover the working age population and in particular young independent adults.

Workfare programmes arise from the need to provide means of income support to the working age population in the absence of functioning unemployment insurance. Budget sustainability is attained by setting quotas, by self-selection – the programme wages are set sufficiently low so that only poor individuals are attracted to the programme – or a mix of the two. Finally, workfare programmes typically offer short-term work prospects.

Workfare programmes have often been first implemented as temporary programmes in response to economic crises. Mexico's *Programa de Empleo Temporal* was introduced in 1995 as part of the government's response to the 1994/95 peso crisis although it has since then been expanded and become permanent (Ferreira and Robalino, 2010). Argentina implemented *Trabajar* after a sharp joint rise of unemployment and poverty in 1996.

India's National Rural Employment Guarantee Scheme (NREGS), established in 2005 differs from previous workfare programmes in its rights-based approach. The scheme guarantees 100 days of paid work to every rural household in the country. Its origins lie in a crisis, like those of other workfare programmes. A pilot workfare programme was launched

[9] Social pensions in South Africa for example have been found to act as a substitute for the lack of unemployment insurance, as the unemployed rejoin families of origin with grant recipients (see Klasen and Woolard, 2008)

in 1965 in the Maharashtra district of Sangali and helped insulate the population from the effects of draughts in 1970/73. The State Legislature made the programme a rights-based state-wide programme in 1979.

Like most workfare programmes, work is unskilled and in labour intensive activities. The majority of projects contribute to building or maintaining infrastructure, including social infrastructure. Work is paid on a piece-rate basis. If employment is not provided within 15 days of the request, job seekers are entitled to an unemployment allowance (25 % of the wage rate during the first 30 days, 50% beyond that).

Early reports on the NREGS suggest that the programme is being well implemented in states that are better governed and with a longer history of good performance in social protection, such as Kerala, while implementation is more difficult in other states (Jacob and Varghese, 2006 ; Louis, 2006). Reporting on a 2008 survey, Drèze and Khera (2009) show that 98 percent of respondents wanted at least 100 days of paid work, but only 13 per cent had worked 100 days in the preceding year.

As the programme is still in early stages, there are no full-fledged evaluations of its impact. An ex-ante simulation carried out by Murgai and Ravallion (2005) found that 100 days of paid work in rural India would lead the poverty rate to fall from 34 to 25 percent, with larger proportionate falls in the poverty gap and the squared poverty gap. They estimated the cost of such a programme to be between 1 and 5 per cent of GDP.

Workfare programmes' greatest contribution is not only to increase incomes, but also to reduce the variability of incomes. They are of great value in areas where rain-fed agriculture is the main occupation, as they can limit the impact of the lean season on incomes. Dev (1995) presents evidence that labourers in the villages covered by the NREGS predecessor in Maharashtra had income streams that were almost 50 per cent less variable than those of labourers in uncovered villages.

India's NREGS is certainly the largest rights-based workfare programme in the world, covering 50 million households. Workfare programmes are also increasingly common in other countries and other regions. Another oft-mentioned example is that of Ethiopia's Productive Safety Net Programme, which has 8 million participants. In Latin America, where workfare does not have the same traditional weight, countries such as, Argentina, Bolivia, Chile, Colombia, Mexico and Peru introduced workfare programmes in the late 1990s and the 2000s (Ferreira and Robalino, 2010).

Institutional innovations: differences and commonalities

Conditional cash transfers, workfare programmes and other institutional innovations have spread from one country and continent to the next. As a result, the menus of social protection options available to social planners in different countries have converged. This has happened despite very different starting points across countries (Barrientos and Hulme, 2008).

One of the remarkable features of these programmes is that they were first implemented in developing country contexts. This may have helped in having programme designs that better respond to the challenges that are specific to developing and emerging countries, including labour informality and relatively weak administrations and in turn making the programmes more easily implementable across borders.

The Southern origin of these programmes also suggests an important role for south-south cooperation in programme design, if not necessarily in programme finance. Indeed, a wave of south-south cooperation has emerged in the field of social protection, with Brazil as a leading actor.

Beyond their country of origin, a few common patterns emerge from recent innovations. We focus on the imposition of conditionalities, the issue of targeting and the individualisation of rights and responsibilities.

The first is the imposition of participation or conditions. Although this may seem obvious now, suffice it to recall that direct food aid and commodity subsidies were the key instruments in social assistance in the developing world prior to the 1980s. They are of course, still used today. Food aid was and is often delivered through schools to ensure adequate nutrition outcomes of children. Subsidies to staple foods (bread, maize or rice) or energy (usually kerosene and/or gas) benefit the whole population.

Newer programmes have introduced counterparts. At the very least, these include signing up to the programme, effecting a form of self-selection. For the most part, however, the counterparts are much more substantial. Conditionalities in CCT programmes often include citizen obligations, such as fulfilling compulsory education, but often go beyond as is the case of marriage restrictions for girls in South Asia. Workfare programmes include some form of work or at least the availability to work. Newer integrated anti-poverty programmes (such as Chile *Solidario*) pair this with psycho-social assistance.

Such conditions can help achieve the programmes objectives but also ensure that beneficiaries are among the "deserving" poor, in turn helping to build constituencies to support these programmes. Political support is all the more important for those social protection programmes and policies that only affect a minority at the bottom of the income distribution or specific vulnerable groups.

The majority of innovations, especially those implemented in lower-income countries are in social assistance, as they do not require financial contributions to ensure entitlement and are typically financed by donors or general taxation. This inevitably raises the question of the size and financial sustainability of the programme.

Targeting is a common response to the size issue. Programmes increasingly make use of incentive structures to ensure self-targeting. This is obvious in workfare programmes like the NREGS that only rely on such self-selection. Other programmes retain a certain set of

categorical targeting variables (unemployment, gender or age) while still relying on the households' decision to participate as a means to select poor or deserving households.

The concern with targeting is not, however merely technical. By ensuring tax payers that social assistance funds is channelled to poor or deserving households, targeting also increases the breadth of political support for social assistance programmes. In fact, targeted programmes are also often accompanied by transparency and social control provisions. This is most evident when such social control is integrated into the programme as is the case in Bolsa Familia, where citizen committees oversee the functioning of the programme. Other transparency actions include publicising the list of beneficiaries, which is done both in Brazil and in Mexico.

Finally, these programmes effect an individualisation of the social contract. Indeed, the rights and responsibilities lie with the individual or frequently with the household, rather than with the community. Even when the household is collectively responsible, the household head or the woman in the household – who is often selected as the recipient for cash transfers, for example—are made responsible for the children's school attendance. This is an important change especially in African and South-East Asian countries where village and kin networks traditionally play an important role in the management of social risk.

Such individualisation is by no means a general trend. The microfinance revolution for example was built conversely on the Grameen Bank's method of group lending, which used collective responsibility to enforce lending contracts.

Insofar as the social assistance programmes discussed are mediated –if not financed—by the state, the individualisation of the social contract contributes to strengthening the links between individuals and the state.

There remains a flip side to this approach: given the targeted nature of the interventions, individualisation can result in the personalisation of rights and responsibilities, that is their differentiation between individual citizens. That process goes against basic principles of horizontal equality and is potentially disruptive of both social protection systems and social cohesion more widely understood.

THE MISSING MIDDLE IN SOCIAL PROTECTION COVERAGE

Social protection systems composed of a set of means-tested social assistance instruments and a social insurance system that serves mainly formal salaried workers leave a "missing middle" in social protection coverage. In middle income Latin American and Transition countries, social insurance systems are mature, if limited in coverage. In other regions, coverage at the top is achieved mostly through private expenditure and self-insurance in the form of savings.

The emergence of large means-tested social assistance programmes holds promise for closing the coverage gap at the bottom of the income distribution. Indeed, impact assessments and the evolution of the poverty gaps in countries where they have been implemented show that they increase income security as discussed in the previous section.

These innovative instruments need to be complemented by more traditional transfers and support for those of working age who are unable to work and for the elderly, of whom counterparts in terms of work or human capital make less sense. In fact, a number of countries including low income countries have put in place social pensions (Barrientos, 2009; Barrientos *et al,* 2010). Social pensions contribute to filling the gaps left by social assistance interventions with implicit or explicit age limits or focusing on human capital accumulation.

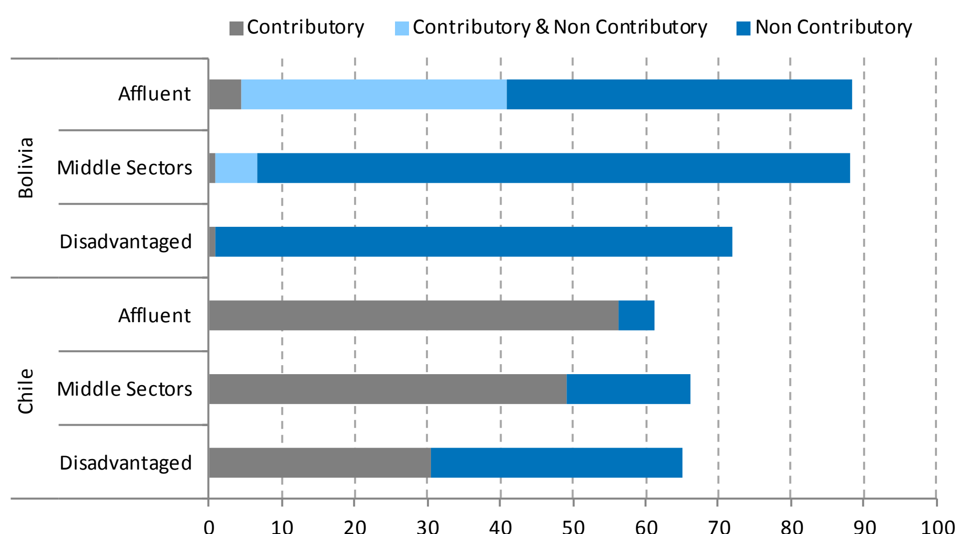
Against certain risks, such as old age poverty, social assistance can fill the gap in coverage. Thanks to social pensions, the share of the elderly receiving regular pension payments is 90 per cent and above is countries such as Cape Verde, Lesotho, Mauritius or Kyrgyzstan. This is despite shares of active contributors to the pension system below 30 per cent, and in the case of Lesotho, of a mere 3.6 per cent of the working age population (ILO, 2010; Barrientos, 2009)

Moreover, social pensions help narrow the coverage gap that exists between rich and poor. Figure 4 shows the share of over 65s in Bolivia and Chile who receive pensions, broken down by income groups[10]. There are dramatic differences in those entitled to pensions from the contribution-based system: in Bolivia 40 per cent of the elderly in affluent households receive such a pension but less than 10 per cent of those in middle income segments do. Once social pensions are taken into account, the differences in coverage are much smaller.

[10] The threshold lines between the three income groups are set at 50% and 150% of the median of adult-equivalent total household income (OECD 2010b).

Figure 4 - Old age pension coverage in Chile and Bolivia

Percentage over 65 receiving pensions in 2006 (Chile) and 2004 (Bolivia)



Source: OECD (2010b) based on National Household Surveys

For pensions at least, the dual model –contribution-based pensions paired with social pensions – seems to work, albeit with room for improvement. First, transfers can be relatively small: USD 2.3 a month in case of Bangladesh, 2400 Bolivianos or 3.5 minimum wages *a year* in Bolivia. Second, although social pensions are progressive, coverage among the poor still falls short, as is the case in Bolivia (Figure 4) or in Bangladesh, where targeting imposes quotas by ward, only reaching 16 per cent of the elderly (Barrientos, 2009).

For the working-age population, such a dual model has an added limitation in the prevalence of informality. The combination of means-tested transfers and contributory social security would only suffice if the informal are poor and therefore covered by social transfers. However, this is not the case.

That poverty and informality do not perfectly overlap is obvious in countries wehre informality rates are substantially higher than poverty rates. That is the case, for example, of Guinea, Mali or India, where informality in non-agricultural employment is above 80 per cent[11], while dollar-a-day poverty headcounts are respectively 70, 51 or around 40 percent[12].

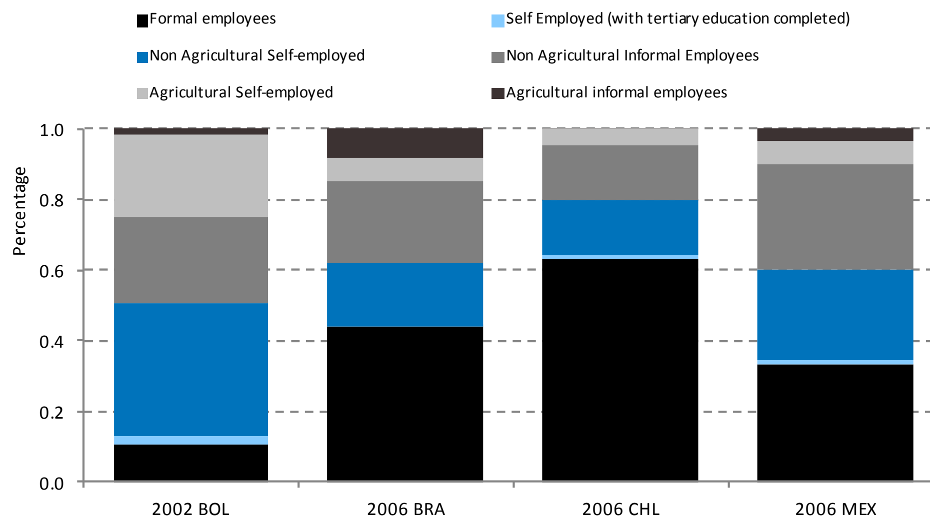
But it is also true in countries with both lower poverty and lower informality. In a study of four Latin American countries based on nationally representative household surveys, da Costa *et al* (2011) find that 44 of the 72 million workers in households with earnings between 50 and 150 percent of median earnings are informal. Figure 5, reproduced from da Costa *et al* (2011) illustrates this point. In the four countries covered, the lower bounr of 50 percent of median household earnings lies above the PPP USD 1.25 a day

[11] Jütting and de Laiglesia (2009)

[12] Latest available PPP USD 1.25 a day poverty headcount rates from PovcalNet

poverty line, so that these would not be considered as part of the core targets of means-tested benefits.

Figure 5 - Informality and occupational status among the middle sectors



Source: da Costa et al (2011) based on National household surveys

Rather than merely dividing workers into formal and informal, workers are split across six occupational groups. One of them is salaried formal workers, while the others include self-employed and informal salaried workers split by their sector of activity (agricultural or not). Self-employed professionals, identified as those with completed higher education, are in a separate group.

The data show that, with the exception of Chile, the majority of workers in the middle of the income distribution are informal. The figure also shows that, although self-employment plays an important role, about 20 per cent of workers in this income bracket in each of the countries are informal employees.

Self-employed workers usually have the option to voluntarily access the social security system in a special regime. Da Costa et al (2011) find that a substantial number of them do. In Brazil, where enrolment is compulsory, contribution rates by the self-employed are about 38 per cent among affluent households and just over 10 per cent among those in middle income segments.

However, the share of informal employees who contribute is much lower. For employees in informal employment, contributions to social security would have to be made in the self-employed regime, effectively subsidising their employers' social security contributions.

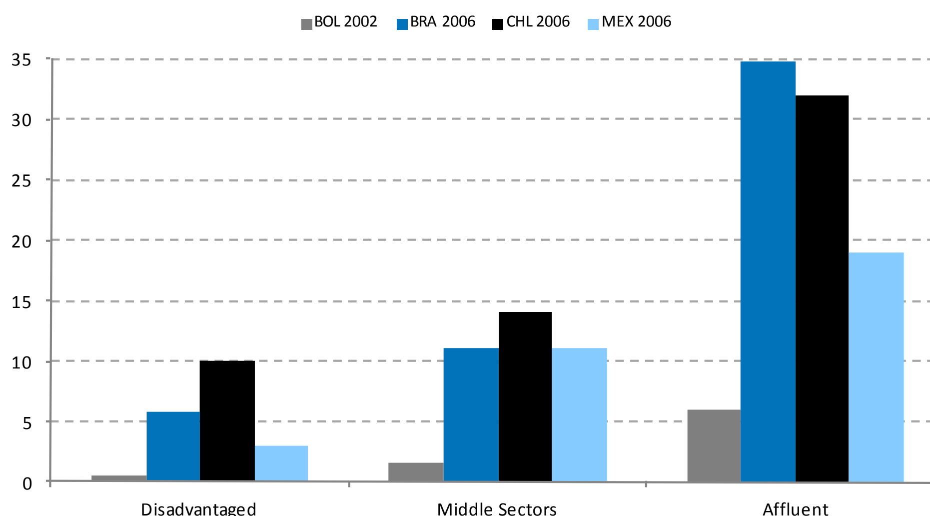
Filling the gaps: innovations in social insurance

Incorporating informal workers into the social protection system is a necessity, a challenge and an opportunity. Despite their being non-poor, many workers in these "middle sectors" are vulnerable and can fall into poverty in times of crisis.

At the same time, though their income streams may be more volatile than those of formal salaried workers, many workers in this missing middle have saving capacity. Moreover, even though average contribution rates are low, the positive relationship between contributions to the pension system and income among informal workers shows that there is latent demand for social protection. Therefore, coverage of middle-income households can also raise money to pay for the social protection system.

Figure 6 - Pension coverage rate for informal workers, by income level

Percentage of affiliates (Bolivia and Mexico) or contributors (Brazil and Chile), share of total workers (14-64 years old)



Source: da Costa *et al* (2011) based on National household surveys

Three different general strategies can help cover the missing middle. The first consists of generalising unbundled contributory instruments with limited risk pooling. By limiting the amount of risk pooling, entitlements are brought in line with contributions, which helps limit adverse incentives for informality.

The clearest example of such an instrument is defined-contribution pensions. In their simplest form, defined-contribution pensions act as retirement savings accounts. They can also grant entitlements to top-up pensions or a redistributive component based on contribution (rather than working) histories, thus allowing informal workers to remain affiliated and contributing even when working informally. It is now well established that in a lifetime, workers in countries with high prevalence of informality tend to move back and

forth between informal and formal jobs. The minimum of annuities, say of 24 years[13] of contributions, for example, is therefore unattainable for many workers, especially those already in the middle of the active phase of their lives.

Pension reform in Mexico is one of the explanations for the relatively high contribution rates among informal workers. They are of 11 and 19 percent for middle sector and affluent workers respectively, despite coverage rates for formal workers being relatively low (at 80 and 87 percent respectively, compared to 99 percent for both categories in Brazil and 95 for both categories in Chile).

The same strategy underpins one of the most popular recent innovations in social insurance from Latin America: Unemployment insurance savings accounts (UISAs). UISAs are mandatory individual accounts to which workers (and their employers) contribute in periods of employment and from which withdrawals can be made, at a specified rate, in periods of unemployment.

The objective of unemployment insurance is more akin to consumption smoothing than poverty reduction. However, it has an important role to play in limiting downward mobility among the middle class. Evidence from Central and Eastern Europe suggests that unemployment insurance reduced poverty among the unemployed by more than 50% in Hungary and 45% in Poland – noting its extensive coverage in this region (78% and 65% of households with unemployed members received the benefit, respectively).[14]

UISAs are widespread in Latin America, where they are used as an alternative or a complement to social security unemployment insurance and severance pay. Brazil's *Fundo de Garantía de Tempo do Serviço* works on this principle and was established in 1967. Most UISAs are relatively small with the exception of Chile, where 22 per cent of the employed population has an active account (Ferrer and Riddell, 2009).

Although UISAs are generally open and compulsory for formal employees only – in part because employers contribute to them as well – the system, much like defined-contribution pensions, could be opened to informal workers at least on a voluntary basis.

The main advantage of UISAs is to get around the verifiability issue caused by informality. With large informal sectors and low entry costs, the typical conditions imposed by OECD countries in their unemployment insurance systems – being unemployed and available to work – are very difficult to monitor. The "moral hazard" problem, whereby incentives to seek work are diminished by the receipt of a benefit, is compounded with the possibility of "double dipping", that is claiming benefits while in fact working informally[15]. Severance pay packages can help cover workers over spells of unemployment, but they are

[13] 24 years is the minimum number of contribution annuities in Mexico to qualify for a pension.

[14] Vodopivec *et al*. (2005).

[15] OECD (2010b)

subject to the solvency of the last employer: in times of crisis, when they are most needed, severance packages may not be forthcoming. To counter this, many countries in the region have introduced self-insurance in the form of individual unemployment savings accounts. Argentina, Brazil, Chile, Colombia, Ecuador, Panama, Peru and Venezuela have all introduced such schemes, especially for dependent workers.[16]

A typical UISA plan does not pool risk across workers and in fact may offer insufficient insurance, especially to young and vulnerable workers. The recent Chilean experience (established in 2002) offers a model with limited risk pooling. Employers and employees contribute both to an individual savings account and to a solidarity fund. The solidarity fund provides top-up benefits in cases where individual accumulated savings are low. Employees who have formal written contracts and who have contributed to the scheme for at least 12 months are entitled to access their savings accounts and withdraw funds. Individuals who have accumulated less than two month's salary in their accounts are covered by the solidarity fund, unless their dismissal was for fair cause (employee misconduct, for example). Since the individual account balance is owned by the worker, the scheme incentivises work search.

Such individualised instruments allow a tight control on costs, since public funds are only needed to manage the system and eventually to top up the capital of the solidarity fund. They offer more a vehicle for self-insurance than insurance per se. In fact, the insurance element may very well be too small and the coverage too limited. In the case of unemployment insurance savings accounts, the mobility between formal and informal jobs limits coverage. Even in Chile, where informality is the lowest in Latin America, unemployed workers are much less likely than average to have been in formal jobs with written contracts – around one-third report having had an atypical contract in their last job, and around 30% no contract at all. What is more, about 60% of the unemployed had been in their last job for less than 12 months (Sehnbruch, 2006). Moreover unemployment is more likely precisely in these categories of workers.

A second strategy consists of drawing workers into contributory systems by subsidising their contributions. This prevents the creation of parallel delivery or financing structure.

An example of this strategy is matched defined contributions in pension finance. These plans are supplementary to obligatory social security pension plans and work like retirement pension accounts. However, transfers are made by the state to these plans, conditional on the contributions of workers, much as employers match contributions in the formal sector. Such plans have been introduced in Colombia, Mexico and Peru for example.

These are more promising approaches to subsidising contribution-based systems for informal workers because standard tools (tax deductions or tax credits) do not reach most

[16] See the overview by Ferrer and Riddell (2009). Argentina's system covers only construction workers.

informal workers. However, the available evidence from Mexico indicates that so far take up rates have been low (Ferreira and Robalino, 2010)

A similar scheme operates in the state of West Bengal in India. The West Bengal Provident Fund differs from the Latin American experiences in that it was designed to cover workers in the informal ("unorganised") sector and is means-tested. Although not as yet integrated into India's New Pension Scheme, the defined-contribution character of the scheme makes portability and integration much easier than in the case of defined-benefit schemes.

Similar approaches are possible in health financing, whereby the coverage of the uninsured (usually on a means-tested basis) is financed by a providence fund in the context of a system where private care providers play an important role. For example, in Chile, the unemployed or inactive and low-income workers are covered by FONASA (*Fondo Nacional de Salud*) and have access to care in the public system and partial coverage if they want to access private healthcare.

The third and final strategy to fill the missing middle in social protection coverage is to universalise the entitlement to one or several social security functions, often by creating a parallel delivery or financing structure. Universal social pensions (that are not means tested, such as Bolivia's *Renta Dignidad*) are one example of this approach, but the most striking progress has been made in health.

A number of countries have established national health services with the explicit aim of reaching universal health coverage, although coverage is often limited to a pre-established list of conditions.

The development of such programmes has often been gradual but remarkably fast. Thailand introduced a Universal Coverage scheme in 2001 to extend coverage to all hitherto uncovered citizens – workers in the public sector and in private enterprises with more than 20 employees were already covered by occupational schemes. This compulsory "UC scheme"[17] helped Thailand reach coverage rates of 98 percent by 2007 (ILO, 2010).

Similarly, Mexico's *Seguro Popular* (*Sistema de Protección Social en Salud*) offers basic healthcare coverage with an annual premium that is degressive in income (and it is free for the bottom income deciles). It was established in the year 2001 and covered 36.8 million people at mid-2010 (Government of Mexico, 2010), reaching 75 per cent of the objective for universal coverage. Unlike the UC scheme in Thailand, the Mexican system relies on voluntary affiliation and on a network of providers that was originally completely independent from that of the social security institute (IMSS) which provides medical services for formal workers. Advances in unifying delivery have been made since 2006, although the dual nature of the health coverage system remains.

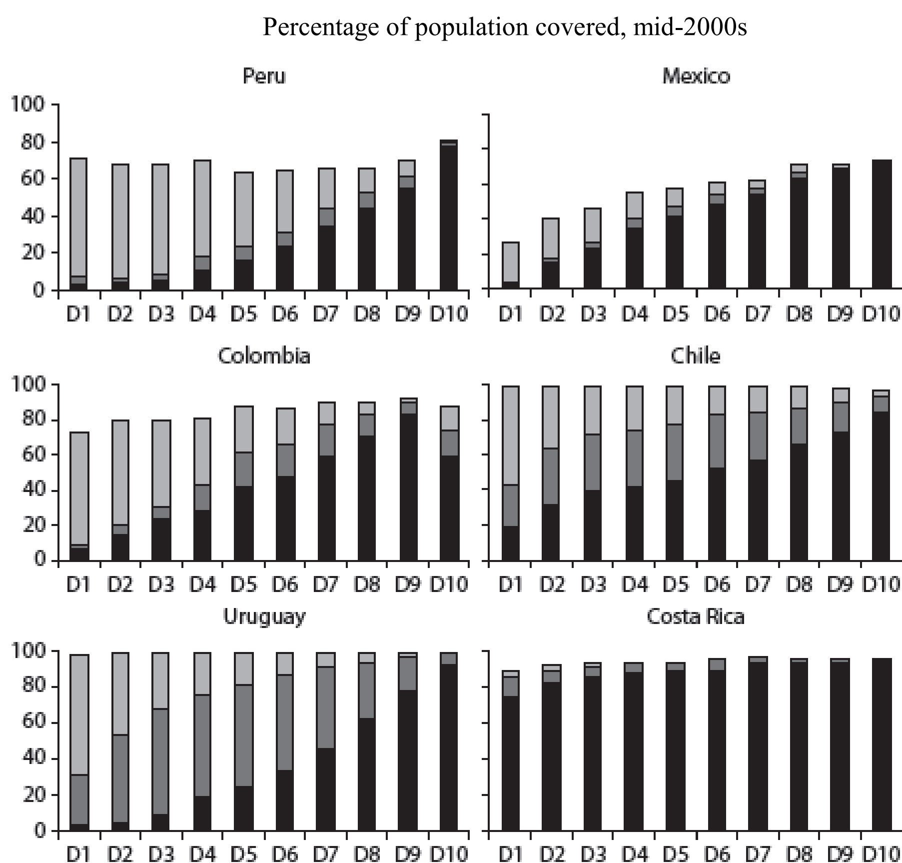
[17] The scheme was originally called the "30-baht" scheme for the sum of the small co-payment requested from beneficiaries. This co-payment was abolished after the change in government in 2006.

Pluralistic approaches have also been used in poorer countries to increase coverage. In Ghana, as in other Central and West African countries, Community Based Health Insurance (CBHI) schemes emerged in the 1980s and 1990s as a response to user fees in healthcare. Especially active in rural areas, these schemes are small-scale, voluntary health insurance programmes, organised and managed in a participatory manner, often at the behest of NGOs, community organisations or even for-profit companies. Relative to traditional, informal mutual help networks, CBHI offer ex-ante well-defined protection with reliable premia (Tabor, 2005). Such insurance allowed members to cover low-frequency, high-cost events, especially hospitalisation when health service supply is available (Jutting, 2003). Despite these advantages, most CBHI schemes remain small: from a subset of 44 schemes Carrin, Waelkens and Criel (2005) found the median value of the eligible population to be 24.9 per cent; 13 schemes had a coverage rate below 15 per cent and only 12 schemes had a coverage rate above 50 per cent. In Ghana by 2002, these schemes only covered 1 percent of the population.

On establishing the National Health Insurance Scheme in 2003, the Ghanaian authorities recognised CBHI schemes and private commercial schemes as two of three forms of insurance, while establishing Community-based District Mutual health insurance as the vehicle for subsidised access to healthcare. These community-based instances identify and categorise beneficiaries, including those (the core poor, those aged 70 and over and retired contributors to the social security system) who are exempt from payment. By 2008, some 12.5 million Ghanaians or 61 per cent of the population are registered with the NHIS (ILO, 2010).

Establishing universal rights for health has therefore proven to be quick and relatively affordable even in lower middle-income countries. Figure 7 (reproduced from Ribe et al (2010)) shows that even in countries with fragmented systems, the coverage gap was greatly reduced by the establishment of national health insurance, universal coverage plans or subsidised access to the contribution-financed system in Latin America.

Figure 7 - Contributory, non-contributory and combined health insurance coverage in Latin America



Source: reproduced from Ribe et al (2010)

The dangers of duality

Increasing coverage by generating dual systems has a number of costs. The strategies outlined above have managed to increase coverage in social insurance at least in certain functions of social security, especially healthcare provision. However, their success in generating contributions from those outside social security systems has been modest at best.

The first challenge is therefore financing. Moreover, many especially those of working age have the capacity to contribute, but their income streams are less verifiable and often more variable than those of formal salaried workers. Therefore, their incorporation into contribution-based systems requires a rethink of the modalities of contribution. Greater flexibility in contribution amounts and regularity, for example, can help incentivise voluntary contribution (Hu and Stewart, 2009).

Moreover, fragmentation also leads to lower risk pooling and increased administrative costs. In the cases where services are not only financed but also provided by social insurance as is the case of national health systems

A greater danger of fragmented systems is that they add to the duality of the economy and especially the labour market. If benefits are not fully portable, job changes that require a change in systems will be more costly for workers. This is particularly true when systems are split according to whether workers are formal or informal, which can reinforce the barriers to move between formal and informal jobs.

When schemes for informal workers are subsidised and comparable to those for formal workers, informality is effectively being subsidised (Levy, 2008). The degree to which this has an effect on the prevalence of informality depends on how easily workers can move between formal and informal jobs and on how much they value other aspects of formal work (including the protection of labour rights other than social security). However, to the extent markets are competitive, such subsidies can alter the marginal returns of *capital* hence slowing down capital accumulation in more productive parts of the economy.

Moreover, if sources of finance differ and non-contributory programmes are financed out of general taxation while contributory programmes are financed out of payroll taxes, formal salaried workers effectively contribute to the system twice. This can erode the support for certain anti-poverty programmes –despite their relatively low cost.

Finally, although this paper has focused on coverage gaps, differences in the depth and breadth of coverage between contribution-based and social assistance remain in fragmented systems. This was already pointed out in the case of social pensions and is also clear from a number of national health services[18].

The issue is not only one of public provision of insurance, but one of missing insurance markets. For informal workers who cannot access social security systems except by subsidising their employer by contributing as self-employed –something that very few of them do—the only remaining option is private health insurance, that rarely caters to their needs.

The lack of adaptation of instruments to the risk profiles of informal workers is also clear in the area of income support. Without access to unemployment insurance, only social assistance can play the role of insurance against temporary falls in income. However, many social assistance transfers, such as conditional cash transfers, are aimed at alleviating permanent poverty – and rightly so, given constraints on the social budget. Moreover, these are often means-targeted, and in the absence of income verifiability, proxy-means targeted.

In practice, if no other instruments are available, proxy-means tested cash transfers will systematically be too little, too late. Indeed, ownership of productive assets is often one of the elements entering the eligibility calculation. Faced with a large income of liquidity shock, such as an illness in the household or a death, households will therefore need to

[18] Although Mexico's *Seguro Popular* has recently increased the number of medical acts that it covers, some national health services have limited coverage even of catastrophic health expenditures. The case of anti-retroviral drugs for HIV-positive patients in the Ghanaian national health insurance scheme is a case in point.

resort to selling their productive assets before they can access income support. By that time, if the assets are lumpy (such as, say a truck or a mobile kitchen) and the transfers relatively small, the household will have fallen into a poverty trap[19].

[19] For evidence of the importance of distress sales in poverty traps, see for example Dercon (1998) or Zimmerman and Carter (2003)

CONCLUSION

The construction of welfare states in the emerging world has already diverged from the history of the construction of welfare states in OECD countries. It differs in the policy interventions that are used, the economic context of openness and the degree of informality which permeates labour relations but has origins and repercussions well beyond labour and social protection policies.

There is certainly more than one social protection model and more than one reform path that will lead to the evolution of social protection policies and welfare states in emerging countries.

By focusing on a small number of institutional innovations, this paper has shown how new social protection instruments have been pioneered in developing countries. Maybe because they were tried and tested in economies with relatively high levels of informality, a more limited administrative and fiscal capacity and lower average standards of living, these have proven successful and have proliferated and been expanded.

However, despite the popularity of some of these instruments, especially that of conditional cash transfers, social protection in most developing countries has evolved haphazardly. This has created unbundled and fragmented systems, that in some cases reinforce divisions in society or in the labour market, especially between formal and informal workers.

Such duality limits the effectiveness of individual programmes and often leaves a missing middle of citizens, especially those of working age who are not poor, who do not have access to adapted instruments of risk management and often can only rely on social assistance if anything. This also undermines the construction of the broad coalitions needed to support a social protection system for all.

Strategies to overcome this gap, from universalisation to the creation of capitalised vehicles for savings and insurance have been discussed. Ultimately social protection systems will benefit from greater integration at least in delivery if not in finance. Bringing contributive social insurance systems to informal workers will help reduce adverse incentives for informality and provide these workers with the opportunity to contribute to the construction of the future welfare states.

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