**TERMS OF REFERENCE**

**WIEGO Social Protection Programme**

**Challenging the global orthodoxies which undermine Universal Social Protection Project**

**An empirical assessment of the impact of social protection on formality in Mexico**

**Enrique Seira Bejarano**

1. **Background**

Worldwide, an estimated two billion people — 61 per cent of all working people in the world and 70 per cent of those working in middle- and low-income countries — work in the informal economy, meaning that they lack the labour and social protections that help smooth income, protect against risk, and keep households out of poverty.[[1]](#footnote-1)

**While not all informal workers are poor, the risk of poverty is higher in the informal economy than in the formal economy.** Moreover, the type of informal employment in which an individual is engaged is correlated with their risk of poverty. In all regions of the world, the structure of informal employment tends to be highly gendered, with women more likely, than men, to work in private households, as contributing family workers, and in more vulnerable occupations such as home-based work.

**Despite the high risk of poverty, most workers in the informal economy do not have access to social protection.** They make up what is often called the “missing middle” of social protection - excluded either de jure or de facto from employment-linked social insurance schemes, they also often fall outside of poverty-targeted social assistance schemes which more often focus on those outsides of the labour market or are means-tested.

**The lack of coverage for informal workers is part of a larger picture of underinvestment and inequalities in accessing social protection.** According to the ILO, just 47 per cent of the global population was effectively covered by at least one social protection benefit before COVID-19. Behind this global average are significant variations across and within regions, between income levels and social protection contingencies.[[2]](#footnote-2)

**Closing the global social protection coverage gap requires significant additional financing.** In 2020, the ILO estimates a financing gap to achieve universal coverage of a basic Social Protection Floor (excluding health care) of US$1,040 billion, representing 3.3 per cent of the GDPs of 134 developing countries studied.[[3]](#footnote-3)

**During 2020, the consequences of this gap in provision were starkly highlighted by the COVID-19 pandemic, which pushed millions into poverty.** According to estimates by the World Bank, in 2020 alone, the pandemic has increased the number of people living in extreme poverty by between 119 and 124 million.[[4]](#footnote-4) The crisis once more revealed the importance of comprehensive and well-designed social protection systems in protecting people’s incomes and wellbeing from shocks. Countries with comprehensive systems in place before the pandemic were generally able to quickly scale-up assistance, whereas those with only weak or tightly limited schemes faced significant difficulties in identifying and reaching those in need of support. Although there was an unprecedented attempt by governments to expand emergency social assistance to groups previously not covered by social protection, most informal workers remained unprotected during the lockdowns of 2020, with severe impacts on incomes, health, and food security.[[5]](#footnote-5)

**Global frameworks and the widely recognized importance of social protection during the COVID-19 crisis generate momentum for the realisation of Universal Social Protection.** At a global level, the Social Protection Floors and Universal Social Protection (USP) frameworks, which are grounded in human rights principles, International Labour Standards, and the Sustainable Development Goals (SDGs), provide a key set of principles and actions which should underpin the extension of social protection to all, including informal workers. These frameworks call for the development of social protection systems that provide protection throughout the lifecycle, are based on a mixture of equitably financed social assistance, social insurance and other measures which provide income protection, and are rights-based, gender-sensitive, inclusive, and representative.[[6]](#footnote-6)

**Yet, achieving USP is held back by a set of influential policy ideas.** Although the framework of USP has gained support from a variety of key social protection stakeholders, including governments, the ILO, IMF, World Bank, and other UN agencies, as well as global civil society organisations, certain key principles remain contested in practice at both the level of global financial institutions and within the design, financing, and implementation of schemes at national level. A key barrier to the expansion of equitably financed social insurance to informal workers is the idea that certain forms of social protection cause large increases informality. The argument proposes that social protection systems which combine employment-linked social insurance with tax-financed social assistance for low-income informal workers, risk creating a substantial increase in informality. WIEGO calls this the ‘Perverse Incentive Thesis’ (PIT), and we believe it has two key elements: 1) mixed social protection systems incentivize informality and, 2) that informality causes low productivity and growth. This consultancy will only evaluate the first one for the case of Mexico’s Seguro popular.

The reason, the argument goes, that such mixed social protection systems induce higher levels of informality, is that social security schemes financed through payroll contributions increase the total labour cost of formal labour. As such non-wage labour costs are not required for informal employment, it becomes relatively cheaper compared to formal employment. This difference provides a sufficiently effective incentive for firms/employers to evade labour and social security laws and generate informal employment. Incentives encouraging informal employment are also hypothesised to exist from workers’ perspectives: The introduction of non-contributory social assistance benefits means that they may be more inclined to accept informal employment, which previously would have meant not being able to access social protection, as they can now access at least some social assistance benefits outside of formal employment. Furthermore, self-employed informal workers – one-person firms – may also choose informality to reduce taxes and contributions, while still being able to access at least some social protection benefits.

This argument was most clearly outlined in Santiago Levy’s 2008 book on Mexico’s social protection system: ‘Good Intentions, Bad Outcomes: Social Policy, Informality, and Economic Growth in Mexico’. [[7]](#footnote-7) Recently, this line of thinking featured notably in UNDP’s 2021 Regional Human Development Report for Latin America, which argues that social protection is central to firms and workers’ decisions to pursue formal and informal work[[8]](#footnote-8). This claim is also deployed in a 2021 report by the IMF, in which the authors warn that means-tested benefits “generate severe disincentive effects and often create poverty traps”[[9]](#footnote-9).

**WIEGO believes it is vital to engage with these arguments quantitatively.** Even if the economic logic is partially consistent, what matters is the size of the effects on informality, and to measure these against the benefits of a USP system**.**

**Existing evidence on the impacts of social protection on labour markets**

At the heart of the PIT is a clear and testable claim: in labour markers with mandatory contributory social security schemes attached to formal employment, which are jointly financed by workers and employers through contributions linked to wages, the introduction of non-contributory social assistance benefits, or subsidised access to social insurance, for workers in informal employment and their dependents leads to sustained increases in the share of workers in informal employment.

Over the last two decades, several studies have set out to test this claim. In addition to Levy’s analysis of the impact of Mexico’s Seguro Popular (a healthcare programme for those outside the contributory social security system), a number of studies in Latin American countries indeed suggest that the introduction of non-contributory social assistance benefits had small positive (i.e. increasing the share of informality in total employment) impacts on informality.[[10]](#footnote-10) Others, however, find that the “evidence of changes in informality due to the design of [Mexico’s] social programs is not strong” and that “under the current distribution, it is hard to obtain sizable changes in informality for realistic changes in taxes and transfers.”[[11]](#footnote-11)

**Quantitatively reassessing the impact of social protection and informality in Mexico**

WIEGO believes that there are important challenges with some of the existing studies measuring the effects of Seguro Popular. These include the following:

* Studies that rely on surveys and variation at the municipality are problematic since they are self-reported, not representative at the municipality level in Mexico, and they cover less than 40 cities.
* The grouping of informal workers is crude in the literature. A possibility is to concentrate on formal jobs, defined as being registered with IMSS (the social security administration). This is the standard definition of formality and focusing on it avoids the controversy of what is an informal job.
* The assumption of non-segmentation in the labour market requires stronger testing. Is it really the case that, for example, earnings by formal sector employees and non-salaried workers are so close that access to a social protection programme would ‘tip the incentive scales? More concretely, is the effect of Seguro Popular significantly different across the skill/wage distribution of formal employees?

With funding from the Swedish International Development Cooperation Agency (Sida), WIEGO therefore plans to conduct a high-quality study evaluating the nuanced impacts of Mexico’s Seguro Popular on informal and formal employment.

1. **Proposed study methodology**

WIEGO aims to employ an identification strategy which makes use of a quasi-experimental design. The effects from participation in the Seguro Popular on formal and informal employment will be estimated through a difference-in-difference (D-in-D) approach using data for formal employment from IMSS. To the extent possible the analysis should be done with IMSS data as in the paper by Bosch & Campos (2014) at the AEA Policy Journal. As is the case in this paper it is possible to exploit the regional variation in the implementation of the social assistance programme to identify a treatment effect using a difference in difference methodology.

1. **Research questions**

* Is there an effect of Seguro Popular (SP) on formal jobs? Does the effect differ by gender, age, labour market attachment, and formal sector salary?[[12]](#footnote-12)
* Are the main conclusions of Bosch & Campos (2014) –- arguably derived from the more robust methodology to date on the effect of SP — maintained when controlling for economic activity at the municipality-year (proxied with lights from space and electricity usage)? Does it satisfy the tests on the new DID literature?[[13]](#footnote-13)
* Researchers will estimate the effect of SP also using distance to a clinic as an instrumental variable for SP adoption at the municipality level.

1. **Consultancy to implement the research**

To undertake the research, WIEGO will engaging the consultancy services of Dr Enrique Seira Bejarano.

As part of the consultancy, Dr Enrique Seira Bejarano has the responsibility to deliver the following outputs:

* **Deliverable 1:** Signing of the contract.
* **Deliverable 2:** Inception report outlining research questions, study methodology, available data, and workplan.
* **Deliverable 3:** First draft of the analysis report, including data sets and Stata codes for review by WIEGO.
* **Deliverable 4:** Revised analysis report based on feedback from WIEGO and potentially external reviewers.
* **Deliverable 5:** A PowerPoint presentation outlining the research framework and key findings and Presentation and discussion of the study in a webinar hosted by WIEGO.

Dr Enrique Seira Bejarano will directly manage, and be responsible for, the full study team, including any research assistants and collaborators.

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| **Deliverables** | **Date** |
| 1. Contract signing. | 25th of April 2022 |
| 1. Inception report outlining research questions, study methodology, available data, and workplan. | 23rd of May 2022 |
| 1. First draft of the analysis report, including data sets and Stata codes for review by WIEGO. | 25th of July 2022 |
| 1. Revised analysis report based on feedback from WIEGO and potentially external reviewers. | 2nd of September 2022 |
| 1. A PowerPoint presentation outlining the research framework and key findings and presentation and discussion of the study in a webinar hosted by WIEGO. | September/ October 2022 (TBD) |

1. **Management**

The agreement will be managed by Dr Laura Alfers, Director of Social Protection, WIEGO, with support from Florian Juergens-Grant, Project Manager, WIEGO. Dr Mike Rogan, Research Associate in the Urban Policies Programme, WIEGO, will provide technical supervision to the consultant.

1. **Ownership and academic freedom**

The report delivered by the academic consultants will be owned by WIEGO. However, the academic consultants have the right to use these results and further elaborations of them to publish academic papers with full academic freedom and without any veto power by WIEGO or any third party. WIEGO will have the ability to comment on the methodology and data use but will not be able to veto the statistical results or their interpretation by the academic consultants in keeping with the aim to have objective rigorous and credible results.

1. **Contact details**

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2. ILO. 2020. [World Social Protection Report 2020–22](https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/@publ/documents/publication/wcms_817572.pdf) [↑](#footnote-ref-2)
3. ILO. 2020. [Financing gaps in social protection Global estimates and strategies for developing countries in light of the COVID-19 crisis and beyond](https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---soc_sec/documents/publication/wcms_758705.pdf) [↑](#footnote-ref-3)
4. World Bank. [2021. Updated estimates of the impact of COVID-19 on global poverty: Looking back at 2020 and the outlook for 2021](https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty-looking-back-2020-and-outlook-2021). [↑](#footnote-ref-4)
5. Alfers, L, Ismael, G & Valdivia, M. 2021. I[nformal Workers and the Social Protection Response to COVID-19: Who got relief? How? And did it make a difference?](https://www.wiego.org/publications/informal-workers-and-social-protection-response-covid-19-policy-implications-2) Policy Insights No. 2. WIEGO COVID-19 and the Informal Economy Impact Study [↑](#footnote-ref-5)
6. Social Protection & Human Rights. [Social Protection Floors Recommendation, 2012](https://socialprotection-humanrights.org/instru/ilo-social-protection-floors-recommendation-2012-no-202/) (No. 202). [↑](#footnote-ref-6)
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8. UNDP.2021. Regional Human Development Report 2021. [Trapped: High Inequality and Low Growth in Latin America and the Caribbean](https://www.latinamerica.undp.org/content/rblac/en/home/presscenter/pressreleases/2021/trapped--high-inequality-and-low-growth-in-latin-america-and-the.html) [↑](#footnote-ref-8)
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11. Alonso-Ortiz and Leal. 2015. [Cross-subsidies, and the elasticity of informality to social expenditures: the case of Mexico’s Seguro Popular](https://www.researchgate.net/profile/Jorge-Alonso-Ortiz/publication/302502214_Cross-subsidies_and_the_elasticity_of_informality_to_social_expenditures_the_case_of_Mexico%27s_Seguro_Popular/links/5730bbed08ae6cca19a1f1e1/Cross-subsidies-and-the-elasticity-of-informality-to-social-expenditures-the-case-of-Mexicos-Seguro-Popular.pdf). [↑](#footnote-ref-11)
12. The ability to answer the heterogeneity question depends on the contingent access to IMSS data at the person level. We are aware that this access may not be realized. [↑](#footnote-ref-12)
13. <https://jonathandroth.github.io/assets/files/DiD_Review_Paper.pdf> [↑](#footnote-ref-13)