

# **Towards a More Resilient Society: Lessons from Economic Crises**

**Report of the Social Resilience Project 2012-14**

**Coordinated by**

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## Foreword

Two financial crises have hit the region during the past two decades. Being aware that we must consider not only economic rescue policies in the short term but also the resilience of social infrastructure against shocks from economic crises in the long term, the Japan National Committee for Pacific Economic Cooperation (JANCPEC) launched the Social Resilience Research Project (SR Project) in 2010 as a Pacific Economic Cooperation Council (PECC) International Project.

The SR Project is designed to shed light on the importance of social safety nets and to closely examine the mechanisms of their roles in the domestic economy. In addition, the SR Project is the first ambitious attempt by the APEC/PECC family to discuss social policy dimensions, as APEC and PECC have traditionally focused on trade and investment liberalization issues.

The first and second SR Projects have a four-fold focus: pension, health insurance, unemployment insurance, and macro-analysis. The first final report, entitled “Towards a More Resilient Society: Lessons from Economic Crises,” was published in October 2010, and the second final report was published in March 2012.

Since 2012, we have attempted to conduct a country study of each Asia-Pacific economy to examine its current social security systems and the challenges for future development and reforms. The studies also include those aspects of social security systems that help realize inclusive growth and create resilient societies. In the Asia-Pacific region, the economic and social circumstances in each economy are significantly different. Thus, individual country studies will be useful to identify salient issues and particular challenges that need to be addressed in the respective economies.

In this report, the SR Project 2012-2014 covered as country cases Chile, Mongolia, Myanmar, Cambodia, China and Columbia. The views expressed herein are the personal views of the individuals indicated, and do not necessarily reflect the views of PECC and The Japan Institute of International Affairs (JIJA). I hope that these inputs will prove useful in showing the way toward resilient societies and sharing best practices among member economies.

September 2015

Yoshiji Nogami  
Chair, JANCPEC  
President, The Japan Institute of International Affairs



# **Social Safety Nets and Inclusive Growth in Mongolia**

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## **1. Introduction**

Although many years have passed since the social insurance system was developed in Mongolia, it is already 20 years now since a new social insurance system was introduced in Mongolia. Up to this point, the Government had entirely financed the insurance service. The new system expresses the meaning of smoothing and decreasing the risk, and reimbursing the harm through the formation of a special fund, that collects social insurance commissions from individuals and employers. This fund, in turn, will regulate the reimbursement of compensation in accordance with the level of wage and period of commission payments.

The first part of this report will be focused on the implementation, development, and the current situation of the social insurance system in Mongolia. The second and the third parts will demonstrate the features of the health and pension insurance system, and the fourth part will state the issues to focus on to provide inclusive growth in Mongolia. At the end of the report, the survey result of the rational expectations-permanent income hypothesis of Mongolian households will be included.

## **2. Social Insurance System in Mongolia: Creation and Development**

All countries have been developing the social insurance system in accordance with their economic and demographic structure, including Mongolia. Some researchers are of the view that from the early 13th century, the issues of social security were included in the State Policy of Mongolia (for example, Attachment 1 illustrates a significant time cycle of social insurance development, suggested by S. Erdene based on his research of Mongolian social insurance development)<sup>3</sup>.

The base of today's social insurance system of Mongolia was established during the socialist period. The first social insurance organization was founded in 1942, and the issuing of compensation to people serving in the military, invalids, supporter losers, industrial accident victims, and mothers with many children were regulated by special rules. The first "Pension Law" was approved in 1958. The principles of this Law were to include all employees in the social

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<sup>3</sup> Erdene, S (2013) "Social Insurance System: reform and direction" (in Mongolia), Academy of Management, Ulaanbaatar, pp.34-39

insurance and to expand the types of compensation. The Government bore all of the costs, and the Labor Union was engaged in this process. According to this law, the employees did not pay any commissions to the social insurance, but the organizations and economic entities paid commissions of a certain proportion from the wage fund on behalf of them. Also, the organizations paid a commission of 3.0% from the scholarship funds and included the students and trainees in the social insurance<sup>4</sup>.

Since 1990, with the transformation into a market economy system, a renovation process started in the social insurance system as well.

During 1993-1996, intensive steps were made to renew the social insurance system to conform to the market economy system. Thus, the “Law on Citizens’ Health Insurance” was approved in 1993, the “Social Insurance Law Packet” in 1994, the “Social Welfare Law Packet” in 1995, and in 1996 the population policy documents were approved by the Government of Mongolia.

According to the “Law on Social Insurance” 1994, there are two forms of social insurance: compulsory and optional; and five types: pension insurance, benefit insurance, health insurance, industrial accident and occupational disease insurance and unemployment insurance. Each of these insurances should have a fund, and the source of the fund and form of financing is regulated by the Law and amendments to the Law.

## **2.1. Social Insurance Coverage**

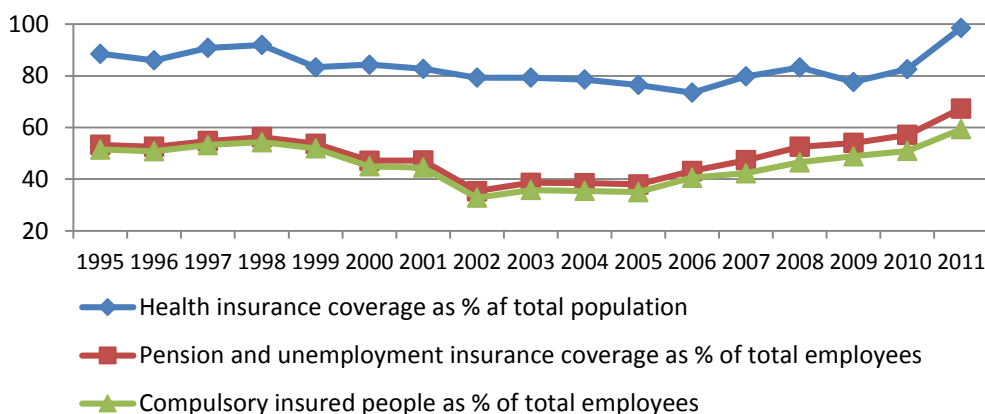
A total of 2.7 million people or 98.5 percent of the population of Mongolia were included in health insurance as of 2011. A high number of those insured are related to schemes in which the Government pays the health insurance commissions of a certain group of individuals on their behalf. In contrast, there are 26,800 employers that pay the social insurance commissions, 686,400 compulsory insured individuals, and 81,600 optional insured individuals. Figure 1 shows there is little difference between 1) pension and unemployment insurance coverage and 2) compulsory insurance coverage as a percentage of total employees. This means there is a small number of optional insured. The above mentioned indexes have a difference of 2% in 2000, 5% in 2007 and 8% in 2011. Thus, there is a need to increase the optional insurance coverage.

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<sup>4</sup> Law of Mongolia: About Pensions, 1971



Figure 1. Social Insurance Coverage in Mongolia

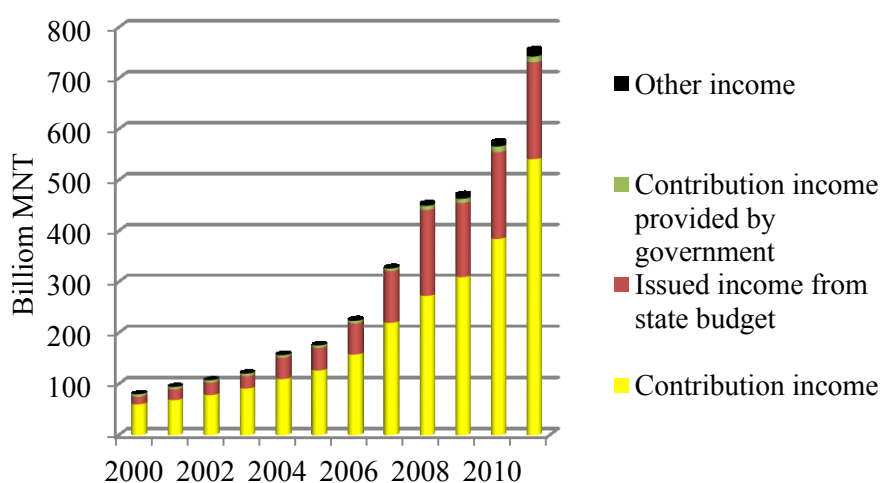


Source: Collection of Social Insurance Statistic. Social Insurance General Office. Ulaanbaatar city in 2012.

## 2.2. Social Insurance Fund Financing

The social insurance fund income consists of: 1) commissions paid by the employers and insurers; 2) finances from the State fund issued for spending on army pensions and pensions before 1995; 3) individuals' insurance commissions, which the Government is responsible for; and 4) others (income from losses and penalties). With the transformation of Mongolia into market economy, organizations and individuals began to participate in compulsory and optional social insurance. As a result, during 1995 – 2011 commission income increased by 26.8 times and reached MNT 540.6 billion from MNT 20.2 billion and accounts for 65-75% of total social insurance fund income (see Figure 2). The index decreased to 60% in 2008. This was due to the changes in Law, by which the employers' payable commission amount was decreased from 19% to 10% in 2008.

Figure 2. Social Insurance Fund Revenue



Source: Collection of Social Insurance Statistics. Social Insurance General Office. Ulaanbaatar city in 2012.

The commission amount, which is the dominant part of social insurance fund income, is settled differently for each of the five types of insurance, and accounts for 21-23% in total (see Table 1).

Table 1. Social Insurance Contribution Rates (in percent of covered wages)

Type of social insurance	Employer	Employee	Total	Private running labor
	Compulsory			Optional
Pension insurance	7.0	7.0	14.0	10.0
Benefit insurance	0.8	0.8	1.6*	1.0
Industrial accident and occupational disease insurance	1.0-3.0	-	1.0-3.0	1.0
Unemployment insurance	0.2	0.2	0.4*	-
Health insurance	2.0	2.0	4.0	Month 670 MNT**
Commission amount	11.0-13.0	10.0	21.0-23.0	

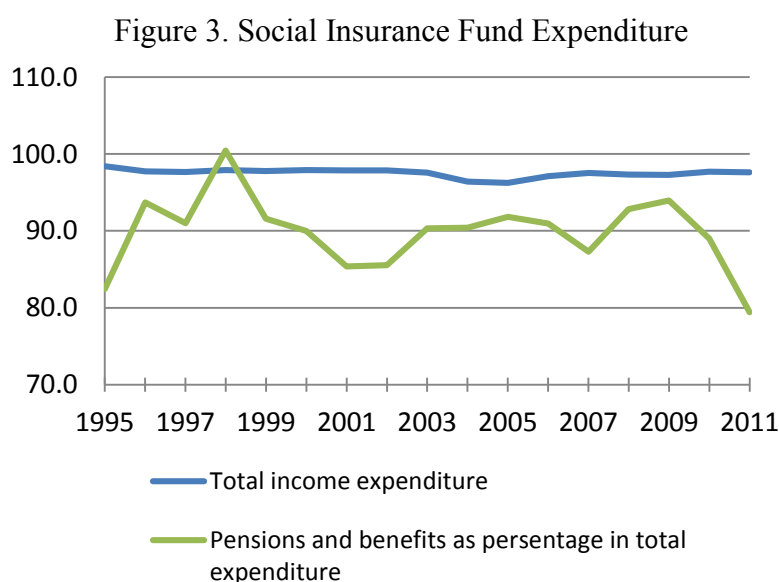
Source: Law of Social Insurance

\*The Law of “Social insurance” changed the employer’s payable pension commission from 0.5% to 0.8% and unemployment insurance commission from 0.5% to 0.2% on October 25, 2012, and following approval, started to be applied from January 01, 2013.

\*\*Herders, students, citizens, whose contributions are paid by the government, and prisoners.

### 2.3. Spending of Social Insurance Fund

For the past 20 years, the social insurance fund spent an average of 89.8% (max 100.4%, min 79.4%) of its total income per annum. Most of this spending, or an average of 97.5% (max 98.4%, min 96.2%) was reimbursed for the pensions, benefits, compensation and assistance services of insured individuals. The remaining 2.5% was spent for the investment and operation cost of the organization of social insurance (see Figure 3).



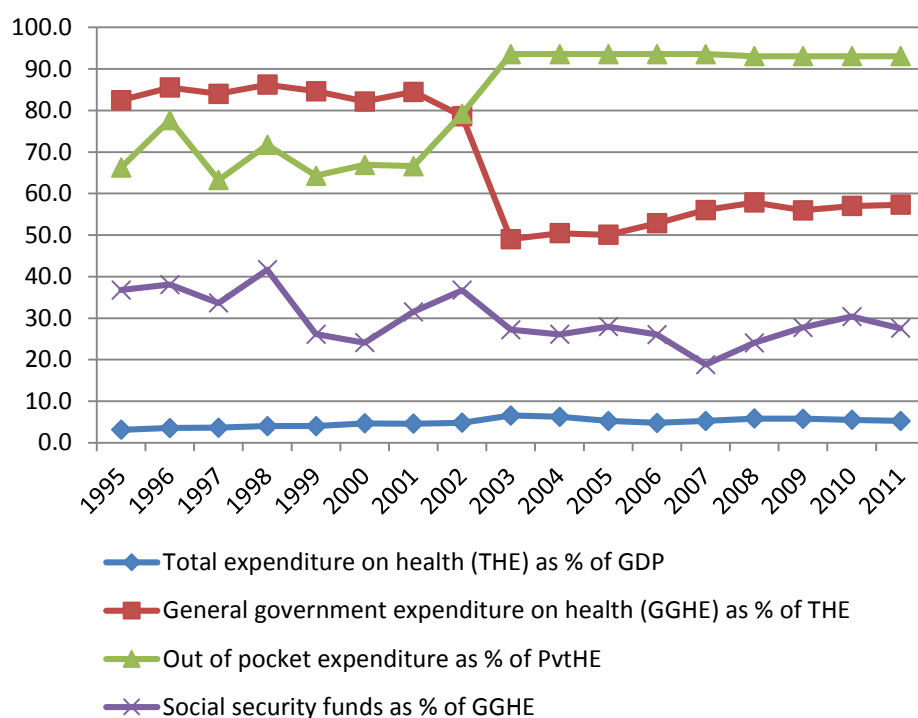
Source: Collection of Social Insurance Statistics. Social Insurance General Office. Ulaanbaatar city in 2012.

## 2.4. Health Insurance Situation

Health in Mongolia has the following features:

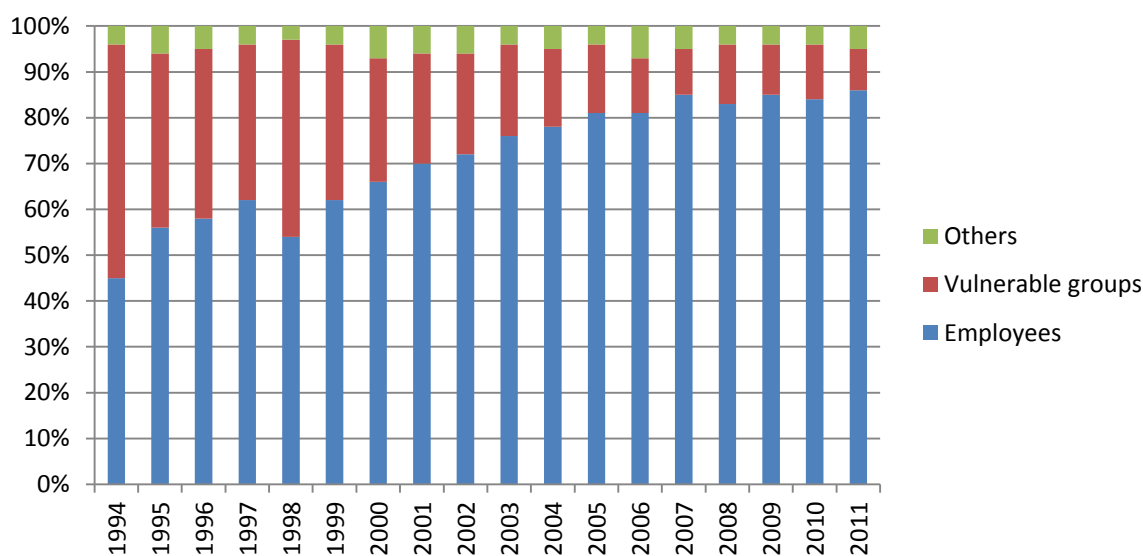
- Mixed financing (budget, insurance, OOP and external). In 2006-2011 total health expenditure (THE) accounts for 5.3-5.8% of GDP, general government health expenditure (GGHE) is 53-57% of THE, out of pocket (OOP) expenditure is 93% of private health expenditure (PvtHE), and social health insurance (SHI) fund is 19-30% of GGHE. This means we have limited SHI role in health financing and a high share of OOP (see Figure 4).
- A visible policy priority on health and free health care at the primary health care level.
- High population coverage by social health insurance (above 90% as shown in Figure 1). For the past few years according to the “Law on Human Development Fund”, individuals’ share of national mineral wealth is located in the health insurance fund as a form of commission reimbursement. This created an automatic growth in the health insurance and influenced the health insurance coverage of population.
- Targeted contribution subsidies for the low income and vulnerable population. Health Insurance contributions of a number of groups are provided by the government. These groups are:
  - Children under 16 years old (18, if the child is studying in secondary school),
  - Individuals without income other than pension,
  - Mothers (fathers) looking after their children up to the age of 2 (3, if twins),
  - Individuals stipulated in the Article 12 of the Law on Social Insurance (individuals of 1st and 2nd degree disability),
  - Persons in regular military service
- The number of individuals provided for by the health insurance by the Government is about 57.5% of total insured individuals as of 2011. However, 86% of commission income of the health insurance fund comes from the commissions paid by individuals (Figure 5).
- Frequent changes to improve health financing through social health insurance;
- A recent policy focus on universal health coverage. Universal Health Coverage (UHC) is a visionary goal to ensure access to preventive, curative and rehabilitative services for all people at an affordable cost when they need them. Therefore, UHC means that all people obtain the health services they need without the risk of severe financial burden by paying for them. The services include prevention, promotion, treatment and rehabilitation. Access to these services must be timely and the services should be of good quality. UHC reflects health equity and the right to health. The currently developed “Social insurance organization’s midterm strategic plan on health insurance: 2012-2016” includes UHC building blocks, such as financing, service delivery, health workforce, information systems, medical products and governance.

Figure 4. Health Financing Trends in Mongolia



Source: World Health Organization, Global Health Expenditure Database<sup>5</sup>.

Figure 5. Health Insurance Fund Revenue by Insured Groups



Source: Social insurance organization's midterm strategy on health insurance: 2012-2016. Social Insurance General Office. 2012

<sup>5</sup> This database is available at <http://apps.who.int>

## 2.5. Pension Insurance Aspects

The pension insurance fund is a main part of the social insurance fund and it is a key factor in promoting social insurance renovation issues.

The present law and regulations, which have effectively been followed for the last 18 years since their approval, formed the contributory pension system, and several times principal changes and amendments have been passed. The commission percentage was previously 19%, and was decreased to 10% through changes passed in 2008. Even though these changes were based on a condition of mutual equality, they resulted in a decrease of the insurance fund income, getting a grant from the state budget, and as a result the rule of independent sustainability has been lost. Although the government suggested repaying the income losses incurred from the commission percentage limit, this was not accomplished.

Through the contributory national pension scheme the formal labor force comprising civil government workers, armed forces personnel and contracted private sector workers are covered by the system on a mandatory basis. The remaining labor force may participate in the system on a voluntary basis. The benefits provided to the formal workers and voluntary participants are the same. The scheme segregates the labor force into two cohorts: those born prior to 1960 and those born in 1960 or later. The benefits available under current law depend on the cohort group of the worker. Those in the pre-1960 cohort are eligible for "defined benefit" pension benefits. Those in the post-1960 cohort have notional account balances and are eligible for "notional defined contribution" pension benefits. The pension benefit has two types - full and reduced - and each of the types has minimum pension benefit provisions.

Beside the contributory pension scheme, the "social pension" is available through the social welfare law for the people at pension age who are not eligible to receive the pension through the Law on Social Insurance<sup>6</sup>.

The social and minimum pension provisions create weak incentives for the informal labor force to pay social insurance contributions, resulting in a majority of retirees receiving a flat minimum benefit.

Pensions for those who retired after 1995 are financed from the pension insurance fund. For those who were retired before 1995 and army people pensions are financed from the state budget. A pension insurance allocation system or the current system that compensates the expenditure by income can be beneficial when the majority of the population is young, low unemployment and the ratio of underwriter and pensioners are positive. However, researchers have estimated that in a situation of population aging and increasing average life expectancy, the current insurance payments contributed to the insurance fund by the present employers and underwriters would not be able to finance the pensions of the present contributors. Thus, the distribution system has to be shifted into a semi-accumulation system gradually.

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<sup>6</sup> Law of Mongolia: About Social Welfare, with changes from Jan. 2012

The pension insurance system of Mongolia has reformed gradually adapting a semi-accumulation system or “pension insurance premium account” approach. Consequently, the Law on pension insurance premium account of Mongolia was approved on June 10, 1999 and came into enforcement from July 1, 1999. In 2005 abstract registration of name accounts was started aiming to capitalize them, bring them into economic circulation and protect them from decrease of exchange rates using annual indexing. However, the accounts still have insufficient registered residuals and a lack of real financing. Thus, the condition of directly calculating and issuing the pension from the named account balance is not completed currently. About 900,000 pensioners opened their named account for pension insurance (Table 2) in 2010, and about 5.6 trillion MNT were accumulated by abstract registration.

Table 2. Number of Insured People by Notional Defined Pension

2000	2005	2006	2007	2008	2009	2010
262885	536723	592125	662536	737306	838830	924375

Source: Social Insurance Statistic Bulletin. Social Insurance General Office. 2012

The allocation system of pension insurance, or the system by which the income covers the expenditure, is seen as favorable when the youth percentage of the population is large, unemployment is low, and a considerable number of the eldest in the population are commission payers. Otherwise, the need arises to take some unfavorable decisions such as to increase the financing from the State Budget into the pension insurance fund, decrease the pension limit, and to increase the commission percent of the insurer and employers.

According to a statement of “Policy options for pension reform” calculated by the World Bank in 2012, “7.7% of the population is over 60 years old in 2010 and it will increase to 28.6% in 2050, in Mongolia”<sup>7</sup>. With the projected increase in number of the elderly in the population, there is a need to reform the system to make sound decisions.

The social insurance issue has been a politically sensitive matter in our country. The governments at different times had taken measures to increase the amount of the pension with no consideration of essential indicators such as the targeted level of income replacement in retirement, the contribution rate of employers and employees, the expected state subsidy by Government; and retirement age. Instead, in favor of the economy, politics and various social factors, the increased amount of pensions were provided by the social insurance fund. During the process, people who have retired at different years with comparable employment experience and status, even similar number of years of contribution to the fund have qualified for unequal levels of pension entitlement. This phenomenon led to the understanding of “pension gap” among the population. One solution for the new challenge is to apply an indexation technique in order to maintain the purchasing power of the salary amount that the pensioner has chosen upon retirement.

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<sup>7</sup> World Bank (2011), Mongolia: Policy Options for Pension Reform

Although the Protocol 153 of the Government from 2012 was confirmed, removing the pension difference and increasing pension measurements utilized about 538.3 billion MNT and the average pension limit became 220,000 MNT by the above mentioned measurement. Then, compared to the rates which have increased more than 2.3 times since 2008 and 53.0 percent from 2011, after pension modernization, an individual's average pension, which is based on the salary in 1995, reached 220,700 and after 1995 the elder pensioner's average pension comparing to 223,200 reached an equivalent level.

The amendment to the law on social insurance was made in 2012. This amendment sanctioned the increase of the pension in regard to the inflation and consumer price increase and made it possible to prevent from the promises of political parties to gain electorates' votes on the pension, an inability of keeping empty promises and may serve favorably to separate the pension from the politics. However, the enforcement is essential.

At the present time, the social insurance sector started to implement decisions which include more scopes. One of the implementations is the "law on recalculation of pension insurance commissions and the labor year" approved by the Parliament. Many people appreciate the chance to reissue one time social insurance for people unemployed during 1990-2000, which aims to provide citizens with social guarantee, who are unemployed due to any other reasons but themselves, when granted leave for changes of organizations, economic entities and privatization, due to the social, economic and political changes in 1990. However, this affected the calculation of the future financing of the social insurance fund and the problems to solve became the next decisive issue for the social insurance organization.

## **2.6. Issues to Focus on**

1. Although about 98 percent of population is included in health insurance in Mongolia, there is a small opportunity that the health insurance services to reach the people. Therefore it is essential to improve the health service benefit package, ensure effective purchasing of health service benefits, strengthen the appropriate organizational, management and functional structure, and develop adequate capacity and capability.
2. There is a need to increase the pension insurance coverage of employees in private sectors. If the number of people under compulsory insurance are subtracted from the total number of employees, 20 percent of the remaining part is included in optional insurance. This means about 80 percent of employees will not be covered by pension funds in the private sector. That is why there is a need for an additional system for optional pension insurance.
3. To develop this kind of system, the development of private sector participation is essential as a form of additional insurance. An additional system of optional pension insurance can be developed in the form of professional and personal savings. However, in Mongolia there is no organizational, operational, and legal environment for developing the additional system for optional pension insurance.

4. How compatible are the existing minimum social insurance pension and welfare benefits? It seems proper to have a design with a truly universal payment system for all citizens over a certain age and a contributory benefit system in addition. The first of the two systems is for poverty prevention in old age and the second one is for the mechanism to replace a portion of working age income when the individual is unable to work. The trade-offs between these aims should be regulated well.
5. There is a need to address the leading issue indicators like pension amount, insurance commission amount, pension age and time in a reasonable manner.

### **3. Impact of Pensions and Benefits on Household Consumption: Case of Mongolia**

Savings and consumption have a decisive role in defining the basic economic terms such as economic growth and the economic cycle. Individual consumption is the largest component of aggregate demand. Consumption accounts for about two thirds of U.S. GDP (Abel, Bernanke 2008, pp. 111). In Mongolia, however, it accounts for about 55% on average over the past five years. As personal consumption is the dominant component of aggregate demand, it is essential to understand the aspects of consumption.

While Keynes' Absolute Income Hypothesis proposes that income affects consumption, the Permanent Income Hypothesis proposes that consumption is not affected by current income, but determined by lifetime wealth. In 1978, Hall studied the permanent income hypothesis, expanding it with uncertainty and rational expectations. The Permanent Income Hypothesis considers that the current consumption is determined by one period lagged consumption and the other related details are included in this lag. Therefore, consumption is considered as a random-walk process.

The aim of this study is to test whether the Rational Expectations – Permanent Income Hypothesis applies in the case of Mongolia, and to determine the impact of the pensions and benefits on changes in Mongolian household consumption.

There are two main reasons why we have chosen the Rational Expectations – Permanent Income Hypothesis developed by Hall rather than other consumption theories. The first is that it has good micro fundamentals, i.e. it studies consumers' decision making processes. The second is that it has been improved and expanded from previous theories.

The first part of this study provides an overview of researches conducted previously. The second part is focused on prevailing theories of consumption. Furthermore, the data used and empirical analysis have been included. At the end, a short summary has been made.

#### **3.1. Literature Review**

There are several empirical researches about permanent income hypothesis. This paper will review the basic studies. Further, results of studies conducted in developed and developing countries are shown in Table 3.



### **Robert Hall (1978) - Stochastic implications of the life cycle-permanent income hypothesis: the theory and evidence**

In this research consumption is seen as a random-walk process that contains constant variables, where it is not possible from current consumption variables to presume future consumption. This was presented by theoretical and empirical studies. U.S. quarter frequency macro data 1948-1977 was used in his empirical study. He took the consumption as real expenditure on non-durable goods and services per capita, and the income as real disposable income per capita. For the agent, who aims to maximize his/her lifetime expected satisfaction, conditional expectation of current consumption depends on prior consumption and all other consumption data does not affect the current consumption. Time lagged explanatory variables are seen to be determined exogenously and used in an estimation of the Least Square Method (LSM). He also estimated many regressions. The first, the one period lagged consumption has a significant role for the estimation of the consumption, i.e. current consumption has an explanatory power for the consumption one period later. The second, in estimation of consumption relating to some prior period lags, the lags except for the one period lag taken all together or individually had no impact on current consumption. If more than one period lagged consumption has predictive power for current consumption, this means that Hall's hypothesis is rejected. (Hall 1987, pp. 981-982). The third checked whether the income affects the consumption. Previous researches by Hall show that income lag meanings have explanatory power for current consumption. However, this hypothesis is not stable. The reason is that forward-looking consumer's behavior is based on the permanent income hypothesis (Hall 1978, pp. 973). While checking the impact of income, Hall estimated expanding the previous regression method and adding current income lag meanings, but this also could not imply the consumption. At the end he checked the impact of wealth on the consumption. The aim was to check whether temporary wealth impacts the consumption. The wealth was taken as the real price of shares and represented by the S&P index. The result of this analysis showed that one period lagged wealth has an effect on the consumption and the impact rate was comparatively low.

Current income does not predict the future consumption. However, the result shows that current share prices may contain data to predict later period consumption. Due to consumption's exogenous character, during stabilizing policy it is impossible to affect the consumption by income.

### **Campbell, Mankiw (1990) - Permanent income, current income and consumption**

This research examined the permanent income hypothesis using the instrumental variables methodology. There are two types of agents in the economy and their disposable incomes are  $Y_{1t}, Y_{2t}$ . Total disposable income  $Y_t$  is equal to the sum of these two agents' disposable income:  $Y_t = Y_{1t} + Y_{2t}$ . The first group agents' income holds constant  $\lambda$  part of total income:  $Y_{1t} = \lambda Y_t$ ,  $Y_{2t} = (1 - \lambda)Y_t$ . Furthermore, the first group agents use current disposable income:  $C_{1t} = Y_{1t}$ .

Their consumption is not sustainable over the period of time. The first rank distinction is:  $\Delta C_{1t} = \Delta Y_{1t} = \lambda \Delta Y_t$ . While the second group agents use disposable permanent income:  $C_{2t} = Y_{2t}^P = (1 - \lambda)Y_t^P$ , the change of consumption depends on permanent income change. Hence,  $\Delta C_{2t} = \mu + (1 - \lambda)\varepsilon_t$  (Flavin 1981, pp. 990). Here  $\mu$  is constant, and  $\varepsilon_t$  is an expectation error of the agent's permanent income expectation in period of  $t - 1$  and  $t$ . While examining the impact of income change on the consumption change Flavin (1981) determined a model that depends on the permanent income expectation error and income change lag (with weak coefficient). When permanent income prediction is possible the consumption change depends on permanent income expectation error. The aggregate consumption change is then:

$$\Delta C_t = \Delta C_{1t} + \Delta C_{2t} = \mu + \lambda \Delta Y_t + (1 - \lambda)\varepsilon_t \quad (14)$$

While examining the permanent income hypothesis it is recommended to check whether  $\lambda = 0$ . In other words, it is checking the impact of income change on current consumption. Equation (14) is not stable in evaluating by LSM. Although the expectation error  $\varepsilon_t$  is not related to time lag variations, it is related to  $\Delta Y_t$ . For instance, high growth of current income brings about a lifetime total income increase, and this will create permanent income growth. This process will impact the growth of consumption. If equation (14) is estimated by LSM then the  $\lambda$  indicator will be overestimated (Campbell & Mankiw 1990, pp. 266). Thus, they found unrelated instrumental variables which are highly dependent on income change but independent of model error, and estimated equation (14) by the instrumental variables method. As a theoretical implication, time lag variables are not related with error. The main requirement of instrumental variables is that the variable has to have a strong relationship with income change. They used many instrumental variables such as income and consumption increase time lag, shares' real price change time lag, and real loan interest time lag.

As a result, income change and consumption change became related. Or in other words, it does not achieve a result compatible with the permanent income hypothesis.

Table 3. Limitations of the Subject

	<b>Research name, researchers</b>	<b>Core data</b>	<b>Methodology</b>	<b>Result<sup>8</sup></b>
1	Gregory Chow (1985) "A Model of Chinese National Income Determination"	China, 1953-1982, year, real GNI, real personal consumption	A model with multiplier, 2SLS	Hypothesis applied
2	Warwick McKibbin, Anthony Richards (1988) "Consumption and Permanent Income: The Australian Case"	Australia, 1962-1987, quarter, real disposable income per capita without seasonal affect, non-durable goods' real consumption per capita	Hall (1978), Hayashi (1985)	Hypothesis applied
3	Roland Craigwell, Llewyn Rock (1990) "Evaluating the Rational	Four Caribbean countries, 1954-1988, year, real GDP	Flavin (1981), VAR	Hypothesis rejected

<sup>8</sup> Permanent income hypothesis applied or not

	Expectations - Permanent Income Hypothesis: Evidence from Caribbean Countries”	per capita, real personal consumption per capita		
4	Thornton (1993) “A Test of the Rational Expectation Permanent Income Hypothesis for Singapore”	Singapore, real disposable income per capita, non-durable goods’ real consumption per capita	Hall (1978), Flavin (1981)	Hypothesis applied
5	Ahmed Khalid (1994) “Empirical Tests of the Rational Expectations- Permanent Income Hypothesis: Evidence from Pakistan”	Pakistan, 1960-1992, year, real disposable income per capita, real personal consumption per capita	Hall (1978), Flavin (1981)	Hypothesis rejected
6	Halit Yanikkaya (2003) “Household consumption expenditures in Peru: A test for the permanent income hypothesis”	Peru, 1994, cross section data of 3,126 households, household income, household consumption	LSM	Hypothesis rejected
7	Miki Kohara, Charles Yuji Horioka (2006) “Do Borrowing Constraints Matter? An Analysis of Why the Permanent Income Hypothesis Does Not Apply in Japan”	Japan, 1993-2004, year, panel data of 1,006 households	Panel, IV, logit, probit	8-15% of household has a borrowing constraints
8	Bilgili, Faik (2006) “Random walk, excess smoothness or excess sensitivity? Consumption in Turkish economy”	Turkey, 1987-2003, quarter, real GDP, real personal consumption, quarter dummy	VAR	Hypothesis rejected
10	Gabriela Lopes de Castro (2006) “Consumption, disposable income and liquidity constraints”	Portugal, 1980-2005, quarter, household real disposable income, non-durable goods’ real consumption of household	GMM, Kalman filtering	Hypothesis rejected
11	Andrew Benito, Haroon Mumtaz (2006) “Consumption excess sensitivity, liquidity constraints and the collateral role of housing”	Great Britain, 1992-2002, year, panel data of 5,500 households	“Switching” regressive model	20-40% of household high sensitive to income
12	D. Demberelmaa (2012) “Mongolian household consumption, future trend”	Orkhon Province, Mongolia, 487 households	Keynes (1936)	
13	Gudarzi Farahani Yazdan, Merabirad Sina (2013) “The testing of Hall’s permanent income hypothesis: A case of study of Iran”	Iran, 1980-2010, year, real GDP, real personal consumption	Campbell, Mankiw (1990)	Hypothesis rejected
14	Alice Ofwona (2013) “An estimation of the consumption function for Kenya using Keynes’s Absolute Income Hypothesis”	Kenya, 1992-2011, year, real income, real personal consumption	Keynes (1936)	Hypothesis rejected

### 3.2. Theoretical Aspects about Consumption

There are many different theoretical aspects about consumption. Let us look at an overview of the main theories and models about consumption starting from Keynes' theory in 1936 to Hall's suggested hypothesis.

#### a) Absolute income hypothesis

Keynes developed the absolute income hypothesis in his work "*The General Theory of employment, interest and money*" (1936). It states that the aggregate demand will determine the production. As consumption accounts for the dominant part of aggregate demand, Keynes suggests that it is possible to manage the production by accurately determining the consumption. According to this theory, disposable income determines the consumption. Keynes introduced the following linear function of consumption:

$$C_t = a + bY_t \quad (1)$$

Where:  $C_t$  is consumption at time  $t$ ;  $Y_t$  is disposable income at time  $t$ ;  $a$  is consumption when income is zero ( $a > 0$ ); and  $b$  is the marginal propensity to consume or the amount of change in consumption in response to a change in income ( $0 < b < 1$ ).

Keynes' theory suggests that with the rise of income the average propensity to consume decreases. However, this is not asserted by the empirical research of Kuznets. Also, in Keynes' theory there is no implication and micro basis of why consumers expend a particular part of his/her disposable income.

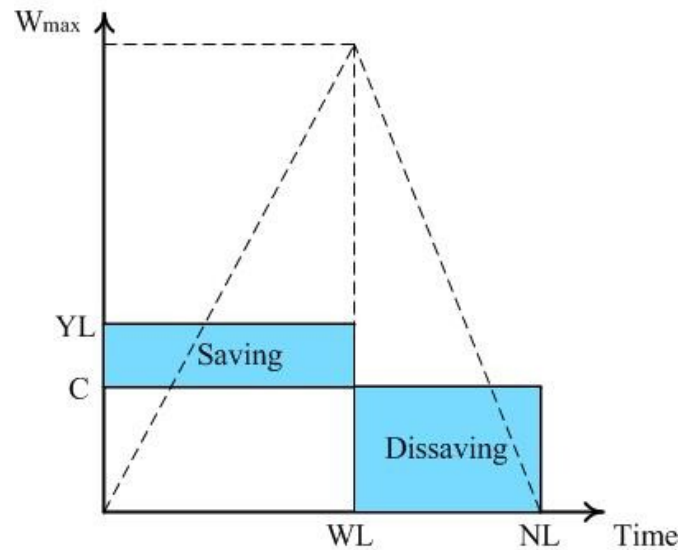
#### b) Life cycle hypothesis

The Life Cycle Hypothesis was developed by Franco Modigliani and Albert Ando in the article "*The life-cycle hypothesis of saving*" published in 1963. This model assumes that peoples' life consists of two stages. In the first stage they will earn income, and in the second stage they will consume their income. The earned income depends on the years of employment. People's accumulated income is highest during the last years of employment. People desire their income to be stable, and they prefer borrowing in the early stages of employment and paying back later when they will earn higher income. In the second stage, when they retire they will start to consume their savings. Savings are seen as a transfer of purchasing power from the younger period to the older period. The consumption function is determined as:

$$C = aWR + cYL \quad (2)$$

Where:  $C$  is consumption;  $WR$  is consumer's real wealth;  $a$  is marginal propensity to consume more than the real wealth;  $YL$  is labor income; and  $c$  is marginal propensity to consume more than the labor income

Figure 6. Consumption, Savings, Wealth, and Revenue



Source: Dornbusch, Fisher, *Macroeconomics* 6<sup>th</sup> edition

Let us assume that there is an individual who expects to live for  $NL$  years. He will work for  $WL$  years, and his income per annum is  $YL$ . After retiring he will not earn income but distribute his savings over the period equal to  $(NL - WL)$  years. As a result of savings, wealth is gained. The wealth will be highest at the end of the last year of the labor. Then a question arises - how much is the maximum amount of wealth he/she will gain? Individuals will consume their lifetime income after their retirement and the maximum lifetime income will be  $WR_{max} = C \cdot (NL - WL)$ . Individuals prefer their consumption to be constant. Population age structure has to be seen as the important factor in defining the consumption and savings behavior.

*c) Permanent income hypothesis*

The permanent income hypothesis was proposed by Milton Friedman in his research work “*A theory of the consumption function*” in 1957. Current consumption consists of permanent (planned, predicted) and transitory (unexpected) elements. The main idea of this theory is that consumption is largely determined by a change in permanent income, and temporary changes in income have little effect on consumer spending behavior. Friedman took an example assuming that there is an individual who earns income each Friday. However, he will not make a choice to consume only on Fridays and not consume on other days. The reason is that people prefer their consumption to be stable. An individual will distribute his income equally over the week (Dornbusch, Fisher 1994, pp. 307). The consumption is proportional to permanent income:

$$C = cYP \tag{3}$$

Where:  $C$  is consumption;  $YP$  is disposable permanent income; and  $c$  is marginal propensity for consumption in response to a change in permanent income

In Friedman's permanent income hypothesis model, the key determinant of consumption is an individual's real wealth, not his current real disposable income. Permanent income is

determined by the consumer's assets (physical and human capital) and the consumer can make an estimation of his anticipated lifetime income. Temporary income is the difference between the disposable income and the permanent income. If the income increased in this year in comparison with the previous, then the increase of permanent income is small due to the fact that temporary income has a small effect on permanent income.

At the empirical level there are two trends in estimating the permanent income. The first, based on micro data, is that the household disposable income is measured by estimating it in relation with the household's assets (land, capital, labor and others). The second is that the permanent income is measured by the weighted average of current and previous income, and this method is favorable for time line data. However, this method is criticized by Lukas (1976).

*d) Rational expectation-permanent income hypothesis*

Robert Hall (1978) in his article '*Stochastic implications of the life cycle-permanent income hypothesis: Theory and evidence*' demonstrated the consumption as a random-walk process. He took an example of an agent who lives in a period  $T$ . Loan interest and discount interest are assumed to be zero. A consumer's satisfaction function  $U(\bullet)$  is seen as quadratic and concave  $U'(\bullet) > 0$ ,  $U''(\bullet) < 0$ . The consumer makes a decision in every period of his life to maximize his/her lifetime expected total satisfaction. For the period of time whenever there is new information in the economy, the consumer uses it for his/her future income expectation, and increases the total satisfaction expectation. The function is:

$$E[U] = E_{t-1} \left[ \sum_{t=1}^T \left( C_t - \frac{a}{2} C_t^2 \right) \right], \quad a > 0 \quad (4)$$

$E[U]$ : expected total satisfaction

$E_{t-1}$ : rational expectation operator of period  $t - 1$ <sup>9</sup>

$C_t$ : consumption during period  $t$

$a$ : positive, constant figure

Let us explain the reason why the quadratic satisfaction function has been chosen. A consumer aiming to maximize his/her satisfaction (derivation from satisfaction function by consumption) will make a decision based on marginal satisfaction. When the satisfaction function is quadratic, then marginal satisfaction will be linear and this makes the stochastic model analysis easy. Particularly, the expected marginal satisfaction of the consumption will be the same as the marginal consumption satisfaction of the expectation. In other words,  $E_1[1 - aC_2] = 1 - aE_1[C_2]$ .

The weak point of the quadratic satisfaction function is the existence of a bliss point<sup>10</sup>. A quadratic function is drawn in parabola form and has a maximum point. If the level of

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<sup>9</sup> No distortion in rational expectation, i.e. using all the data of period  $t - 1$ , period  $t$  is predicted. Prediction error (the difference between the prediction and the fact) is unrelated with period  $t - 1$  data.

consumption exceeds the maximum point, then the marginal satisfaction will turn negative. As a negative marginal satisfaction has no economic meaning, the consumer makes a decision to remain in the area where the marginal satisfaction is positive.

The budget constraint is illustrated as follows:

$$\sum_{t=1}^T C_t \leq A_0 + \sum_{t=1}^T Y_t \quad (5)$$

Where  $A_0$  is initial wealth, and  $Y_t$  is income. Lifetime consumption is not more than the sum of initial wealth and lifetime labor income. However, by the ‘cormorant’ axiom additional consumption brings additional satisfaction, which is why a consumer who aims to maximize his/her satisfaction will use his/her whole wealth. There are no borrowing constraints. Thus, the consumer has a condition to repay the outstanding loan at the end of the life.

A consumer chooses the rational level of his/her consumption within the frame of the data he/she has. Expected marginal satisfactions are equal to each other.

$$C_1 = E_1[C_t], \quad t = 2, 3, \dots, T \quad (7)$$

From equation (7), we can see that the consumption will be at the same level as previous if there is no shock. In other words, the consumption is a random-walk process.

$$C_t = C_{t-1} + e_t \quad (8a)$$

$$E_{t-1}[C_t] = C_{t-1} \quad (8b)$$

Where  $e_t$  is a constant variation random error with zero average. The consumer will equally distribute his/her consumption to the period of time to maximize the lifetime satisfaction. Let us suppose consumption growth is expected. Then the current marginal satisfaction of consumption will be greater than the expected marginal satisfaction in the future. Thus, it is reasonable to increase the current consumption.

If we take expectations from both sides of the budget constraints, then:

$$\sum_{t=1}^T E_1[C_t] = A_0 + \sum_{t=1}^T E_1[Y_t] \quad (9)$$

If we substitute equation (7) into equation (9), then the left side of equation (9) becomes  $TC_1$ . From where  $C_1$  will be:

$$C_1 = \frac{1}{T} \left( A_0 + \sum_{t=1}^T E_1[Y_t] \right) \quad (10)$$

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<sup>10</sup> From a certain point additional consumption decreases the satisfaction, thus from that point a marginal satisfaction will have a negative meaning (B. Binger and E. Hoffman 1997, pp.113)

Let us find the relation to "e", which changes the consumption. For this purpose we will find the change of consumption in the first and second periods of time. If we rewrite equation (10) for  $C_2$ , then:

$$C_2 = \frac{1}{T-1} \left( A_1 + \sum_{t=2}^T E_2[Y_t] \right) = \frac{1}{T-1} \left( A_0 + Y_1 - C_1 + \sum_{t=2}^T E_2[Y_t] \right) \quad (11)$$

Where  $A_1 = A_0 + Y_1 - C_1$

We can illustrate the second period's lifetime income expectation by adding the previous period's expectation. The difference between them is the difference between the first and second periods' data. Let us write equation (11) as follows:

$$C_2 = \frac{1}{T-1} \left[ A_0 + Y_1 - C_1 + \sum_{t=2}^T E_1[Y_t] + \left( \sum_{t=2}^T E_2[Y_t] - \sum_{t=2}^T E_1[Y_t] \right) \right] \quad (12)$$

According to equation (10):  $A_0 + Y_1 + \sum_{t=2}^T E_1[Y_t] = TC_1$ . From here equation (12) can be compressed and rewritten, so that:

$$\begin{aligned} C_2 &= \frac{1}{T-1} \left[ TC_1 - C_1 + \left( \sum_{t=2}^T E_2[Y_t] - \sum_{t=2}^T E_1[Y_t] \right) \right] \\ &= C_1 + \frac{1}{T-1} \left( \sum_{t=2}^T E_2[Y_t] - \sum_{t=2}^T E_1[Y_t] \right) \end{aligned} \quad (13)$$

From equation (13): the change in consumption is equal to consumer's lifetime income expectation difference divided across the remaining time of the consumer's life. The consumer expects the future income and expectations in each period of time might be different. This expectation of difference creates consumption change. That is, expectation of change of permanent income creates a change in consumption.

### 3.3. The Data: Impact of Pensions and Benefits on Household Consumption. Case of Mongolia

The data used is from the 4<sup>th</sup> quarter, 2004 to the 4<sup>th</sup> quarter, 2012 of households' socio-economic selected surveys drawn from monthly Statistical Bulletin<sup>11</sup>. As the detailed data of households' durable and non-durable goods and services expenditure was not available, the households' total consumption expenditure was taken as the consumption. The income was taken as pension and compensation income.

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<sup>11</sup> Although it is possible to find data from the GDP measuring method, these are yearly repeated data. Thus, it does not represent a long period of time. That is why 'Household Socio-Economic Survey' quarter data is used.



Household’s monthly expenditure consists of food consumption, non-food goods consumption, and service expenditures. Non-food goods consumption includes: textiles, clothes, shoes, stationery, household goods, pharmacy, health and cosmetics, petrol, and others. Service consumption includes: transport and communications, housing and communal services, household services, education and health payments, and others (NSO Mongolia, “Household Socio-Economic Survey” questionnaires).

Investment type expenditures such as houses and properties are not included in the households’ average expenditures. But non-durable goods like household electronic goods and clothes are included, as these are not investment type expenditures. Thus, no distortion will arise in the estimation due to the households’ consumption data.

In the economy, real indicators are important in decision making, thus the country’s average<sup>12</sup> household income and expenditures are converted to real indicators using the consumer price index. The consumer price index is the index which illustrates the expenditure on goods and services in the consumer basket compared to a base year. Hence, it is convenient to convert the household income and consumption to real indicators. In empirical researches to test the permanent income hypothesis per capita indicators are used. It is reasonable to choose as a representing agent an individual who aims to maximize his/her lifetime satisfaction. That is why we obtained per person indicators dividing the household data into the average number of people in the household. Let us examine the descriptive statistics of real indicators per person.

Table 4. Descriptive Statistics

	<b>Real consumption per capita</b>	<b>Real income per capita</b>
Average	71948	10797
Median	70255	10412
Maximum	101254	20943
Minimum	40262	3824
Standard distortion	13907	5235
Variation coefficient	0.19	0.48
Skewness	0.00	0.54
Kurtosis	2.98	2.34
Jarque-Bera	0.00	2.21
Observation meaning	33	33

Average consumption per capita was MNT 71,948 in 2005, while average income per capita was MNT 10,797. Real consumption has little fluctuation in comparison with real income, and the consumption variation coefficient is comparatively low, at 0.19. Both of these indicators have normal distribution.

In Figure 7, dynamics of consumer price index, average monthly expenditure per capita, nominal and real income per capita indicators are demonstrated.

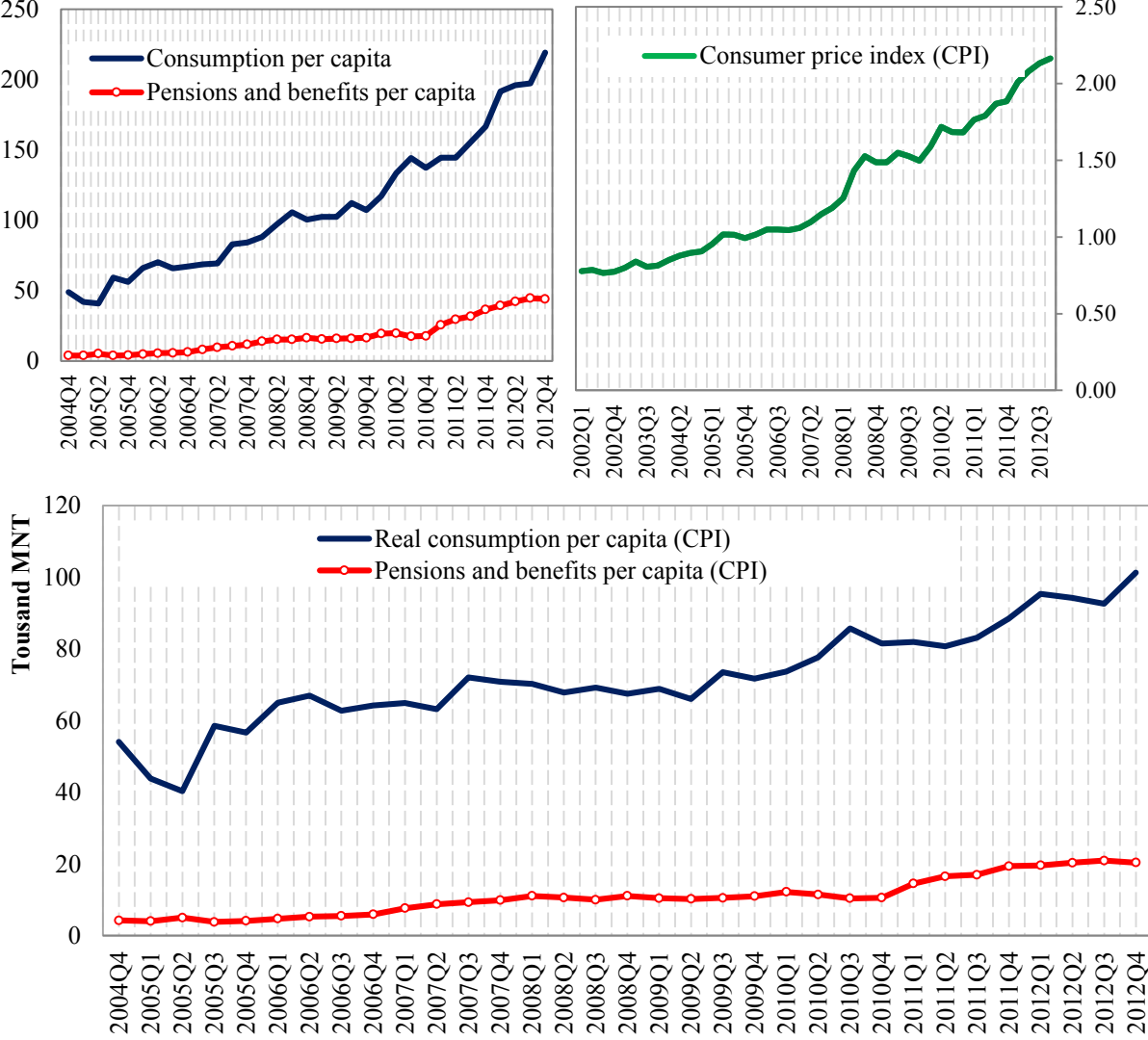
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<sup>12</sup> In the theoretical model representing agent’s consumption decision making is reviewed. In case of using macro level or average data, prediction is needed that there is equal possibility for the agents to get the data about future economic situation.

Nominal consumption and income per capita have generally increased. As at the end of 2012, the income per capita was MNT 44,000, and the consumption per capita was MNT 219,000.

The consumer price index has little fluctuation within its trend, disregarding the second quarter of 2005, 2008-2009, and the second quarter of 2010.

Figure 7. Income and Consumption per Capita, CPI Dynamics



Source: NSO, The Household Socio-Economic Survey

Hall’s model stipulates that the consumption change is unpredictable and the purpose is to test the hypothesis, thus data used by the level indicator is taken without logarithm. Other tests of permanent income hypothesis also use the consumption data without logarithm. For instance, Hall (1978), Campbell and Mankiw (1981) used data without logarithm. Before the time linear estimation it is necessary to test the data line for stationarity. The result of ADF<sup>13</sup> and Phillips-Perron<sup>14</sup> tests are compared and illustrated in Tables 5.

<sup>13</sup> Dickey, Fuller (1981) developed a test for checking the stationarity of time line. The test is based on the following three equations:

Table 5. Stationarity of Variables

Indicators	Explanation	ADF test (p value)			Phillips-Perron test (p value)		
		Level, none	Level, intercept	Level, trend	Level, none	Level, intercept	Level, trend
c	Real consumption per capita	0.96	0.89	0.11	1.00	0.98	0.09*
y	Real income per capita	1.00	0.97	0.69	1.00	0.97	0.62

\* stationary

Test result shows that at the level of 5% importance real consumption per capita is stationary within its linear trend. So, first rank distinction is taken from variables and tested for stationarity.

Table 6. Stationarity of Variables

Indicators	Explanation	ADF test (p value)			Phillips-Perron test (p value)		
		Level, none	Level, intercept	Level, trend	Level, none	Level, intercept	Level, trend
$\Delta c$	Change in real consumption per capita	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*
$\Delta y$	Change in real income per capita	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*

\* stationary

Table 6 demonstrates that the real consumption per capita quarter change at 5% importance level is stationary, as well as per capita real income quarter change.

Since there is a probability of seasonal influence to income and consumption per capita the influence has been examined. There is a possibility of distorting the estimation using data with seasonal fluctuations.

Figure 8 shows that the change of third quarter real consumption per capita is high compared to other quarters, whereas the third quarter change of the real income per capita is relatively low compared to other quarters.

$$\Delta y_t = \gamma y_{t-1} + \sum_{i=2}^p \beta_i \Delta y_{t-i+1} + \epsilon_t$$

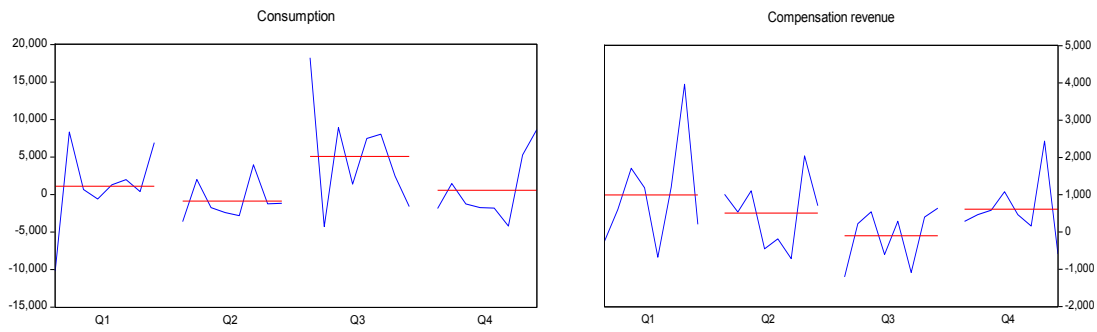
$$\Delta y_t = \alpha_0 + \gamma y_{t-1} + \sum_{i=2}^p \beta_i \Delta y_{t-i+1} + \epsilon_t$$

$$\Delta y_t = \alpha_0 + \gamma y_{t-1} + \alpha_2 t + \sum_{i=2}^p \beta_i \Delta y_{t-i+1} + \epsilon_t$$

During the test Dickey-Fuller's distribution is used (a simple t test is not useful). The critical meaning of each of the above three equations is different. Numeric line is checked by zero hypothesis with unit root:  $H_0: \gamma = 0$ ,  $H_0: \gamma = \alpha_0$ ,  $H_0: \gamma = \alpha_0 = \alpha_2$ .  $\sum_{i=2}^p \beta_i \Delta y_{t-i+1}$ , which is partly expanded to correct the series correlation (Walter Enders 2003, pp. 221-227).

<sup>14</sup> Phillips, Perron (1988) developed a non-parametric unit root test method to check the series' correlation. They measure  $t$  statistics by the modified equation, estimate the equation by the unexpanded Dickey-Fuller test. (Walter Enders 2003, pp. 241-242).

Figure 8. Seasonal Average of the Real Indicators per Capita (in thousands, MNT)



Source: Eviews result

Since it is not possible to determine the seasonal impact from the above figure, regressive analysis was carried out and examined using seasonal dummy variables. The following regressive models were used:

$$\Delta c_t = \alpha_0 + \alpha_1 Q2 + \alpha_2 Q3 + \alpha_3 Q4 + e_t \quad (16a)$$

$$\Delta y_t = \beta_0 + \beta_1 Q2 + \beta_2 Q3 + \beta_3 Q4 + u_t \quad (16b)$$

Where  $\Delta c_t$ ,  $\Delta y_t$  are the quarter changes in real consumption and income per capita;  $Q2, Q3, Q4$  are the dummy variables of the second, third, fourth quarter; and  $e_t, u_t$  are the model's error.

In estimating equations (16a) and (16b) by LSM, the remaining amount was no serial correlation, homoscedastic and normal. Accordingly,  $t$  and  $Wald$  tests were available.

Table 7. Estimation Testing Seasonal Effect

Variable	Dependent variable: $\Delta c_t$	Dependent variable: $\Delta y_t$
	(16a)	(16b)
Constant	1112 (1830)	995 (364)
Q2	-1980 (2588)	-488 (515)
Q3	3976 (2588)	<b>-1095</b> <b>(515)</b>
Q4	-540 (2588)	-383 (515)
$\bar{R}^2$	0.08	0.05
LM*	0.46	0.48
Wald*	0.14	0.22
White*	0.25	0.39
Jarque-Bera*	0.57	0.07

\* probability to demolish zero hypothesis, () in brackets standard error

The result shows that at the 5% importance level the quarter change of real income per capita is more in third quarter than in the first. But real consumption per capita is not affected by season. Thus, income change was adjusted by the Census X12<sup>15</sup> method.

### 3.4. The Estimation Result

According to Hall's hypothesis there is no one factor that explains the consumption, it is determined exogenously. The following regression is to test and estimate this hypothesis.

$$\Delta c_t = \gamma_0 + \sum_{i=1}^m \gamma_i \Delta c_{t-i} + \sum_{s=1}^n \delta_s \Delta y_{t-s} + \varepsilon_t \quad (17)$$

Where  $\Delta c_t$  is the quarter change of monthly real consumption per capita,  $\Delta y_t$  is the quarter change of monthly real income per capita (seasonally adjusted), and  $\varepsilon_t$  is the random error at  $(0, \sigma^2)$ .

Through equation (17) the impact of consumption and income change lags the current consumption, and it is checked by  $\gamma_1 = \gamma_2 = \dots = \gamma_m = \delta_1 = \delta_2 = \dots = \delta_n = 0$  coefficients together and separately that it equals the zero hypothesis. If the zero hypotheses are rejected then the permanent income hypothesis is not achieved. Time lag was determined by  $R^2$ , AIC, SIC<sup>16</sup> adjusted criteria and 30 regressive models with different time lags were estimated (See the Eviews command from the attachment).

Equation (17) was estimated by LSM and predictions were checked through the test for claim. Series correlation was checked by the LM<sup>17</sup> test, heteroscedasticity by the White<sup>18</sup> test, error standard by the Jarque-Bera<sup>19</sup> test. In case of predictions applied the estimated parameters were each checked by  $t$  test, and the correlation effect was checked. The estimation result is shown in Table 8.

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<sup>15</sup> Correcting method developed by United States Census Bureau

<sup>16</sup> These criterion indicators illustrate the adequacy of the model.  $R^2$  is rising with additional explanatory variables, while corrected  $R^2$  is adjusted by the rate of latitude.  $\bar{R}^2 = 1 - [SSR/(n - k - 1)]/[SST/(n - 1)]$  (Wooldridge 2009, pp. 200-201). Akaike Information Criteria (AIC), Schwarz Information Criteria (SIC) are the alternative criteria for measuring the model's adequacy.  $AIC = \ln \frac{SSR}{n} + \frac{2k}{n}$ ,  $SIC = \ln \frac{SSR}{n} + \frac{k}{n} \log(n)$  (Marno Verbeek 2004, pp. 58). Minimum meanings of AIC, SIC demonstrate the model's adequacy improvement. No one of these criteria is seen as the best (Brooks 2008, pp. 233).

<sup>17</sup> Series correlation test was developed by Breusch-Godfrey. The estimation's remainder was estimated in relation with its time lag and explanatory variables. The time lag's impact on the estimated remainder is checked by the LM/F test, and predicted as no series correlation (Wooldridge 2009, pp. 416-419). This method has an advantage of not requiring an exogenous condition other than a Durbin-Watson test.

<sup>18</sup> Having stable error variance is one of the requirements of effective XEKA. White (1981) checked the relation between the error variance and error variance explaining variables' combinations. It tests the error variance stability and homoscedastic zero hypothesis.

<sup>19</sup> Gauss-Markov's assumptions are applied, but if the residuals have normal distribution and the selection is small, then  $t$ ,  $F$ , LM tests will not work properly. The residuals have normal distribution with zero expectation, and critical meaning is seen from squared  $\chi^2$ . If the expectation of zero is not rejected, then the residuals will have normal distribution. At the level of 5% importance,  $\chi^2$  distribution's (average, variance) critical meaning is equal to 5.99.

**Table 8. Estimation Result**

Variables	Dependent variable: $\Delta c_t$														
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Constant	1160 (1019)	1776 (1144)	725 (1008)	604 (1131)	748 (1062)	1480 (1051)	2308 (1175)	1173 (1072)	860 (1115)	1119 (1012)	<b>2655</b> <b>(1184)</b>	<b>2826</b> <b>(1237)</b>	1111 (1192)	723 (1250)	1139 (1060)
$\Delta c_{t-1}$						-0.20 (0.17)	-0.29 (0.20)	-0.20 (0.17)	-0.33 (0.22)	-0.37 (0.19)	-0.38 (0.19)	-0.35 (0.20)	-0.19 (0.18)	-0.32 (0.23)	-0.37 (0.19)
$\Delta c_{t-2}$											-0.21 (0.17)	-0.22 (0.17)	0.02 (0.17)	0.05 (0.18)	-0.02 (0.21)
$\Delta c_{t-3}$															
$\Delta c_{t-4}$															
$\Delta c_{t-5}$															
$\Delta y_{t-1}$	1.29 (0.92)	1.23 (0.96)	0.83 (0.80)	0.74 (0.85)	0.36 (0.75)	1.15 (0.92)	0.78 (0.99)	0.56 (0.83)	0.49 (0.84)	0.05 (0.72)	0.49 (0.96)	0.60 (0.99)	0.58 (0.85)	0.52 (0.87)	0.04 (0.74)
$\Delta y_{t-2}$		-0.89 (0.94)	-0.22 (0.20)	-0.23 (0.84)	0.18 (0.75)		-0.49 (0.96)	0.04 (0.83)	0.02 (0.84)	0.45 (0.71)		-0.54 (0.95)	0.06 (0.87)	0.07 (0.88)	0.44 (0.74)
$\Delta y_{t-3}$			0.79 (0.77)	0.66 (0.83)	0.56 (0.73)			0.63 (0.78)	0.56 (0.81)	0.48 (0.68)			0.60 (0.82)	0.50 (0.86)	0.50 (0.72)
$\Delta y_{t-4}$				0.55 (0.82)	1.44 (0.76)				0.95 (0.85)	<b>1.91</b> <b>(0.75)</b>			0.98 (0.87)	<b>1.90</b> <b>(0.78)</b>	



...continued

		Dependent variable: $\Delta c_t$													
Variables	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)
Constant	1480 (1156)	1398 (1259)	1202 (1303)	833 (1381)	1412 (1170)	1906 (1220)	1813 (1332)	1576 (1412)	1323 (1423)	1395 (1258)	2495 (1270)	2271 (1354)	1957 (1429)	1560 (403)	2148 (1232)
$\Delta c_{t-1}$	-0.21 (0.18)	-0.21 (0.18)	-0.20 (0.19)	-0.32 (0.24)	-0.37 (0.20)	-0.26 (0.22)	-0.27 (0.23)	-0.27 (0.23)	-0.34 (0.24)	-0.37 (0.20)	-0.36 (0.22)	-0.39 (0.23)	-0.39 (0.23)	-0.48 (0.23)	<b>-0.50</b> <b>(0.20)</b>
$\Delta c_{t-2}$	-0.03 (0.18)	0.04 (0.18)	0.01 (0.19)	0.04 (0.19)	-0.04 (0.21)	-0.01 (0.18)	-0.01 (0.19)	-0.02 (0.20)	-0.01 (0.19)	-0.04 (0.22)	-0.22 (0.22)	-0.21 (0.22)	-0.24 (0.23)	-0.27 (0.22)	-0.07 (0.21)
$\Delta c_{t-3}$	-0.04 (0.15)	-0.04 (0.16)	-0.03 (0.16)	-0.04 (0.18)	-0.09 (0.15)	-0.09 (0.17)	-0.09 (0.18)	-0.06 (0.19)	-0.10 (0.19)	-0.09 (0.17)	-0.12 (0.17)	-0.10 (0.18)	-0.07 (0.18)	-0.11 (0.18)	-0.15 (0.16)
$\Delta c_{t-4}$						-0.21 (0.15)	-0.21 (0.16)	-0.20 (0.16)	-0.20 (0.16)	0.01 (0.16)	-0.20 (0.18)	-0.20 (0.18)	-0.18 (0.19)	-0.14 (0.18)	-0.09 (0.16)
$\Delta c_{t-5}$											-0.23 (0.16)	-0.24 (0.16)	-0.24 (0.17)	-0.23 (0.16)	-0.27 (0.14)
$\Delta y_{t-1}$	0.65 (0.83)	0.62 (0.86)	0.58 (0.87)	0.51 (0.89)	0.02 (0.75)	0.76 (0.84)	0.73 (0.87)	0.70 (0.88)	0.61 (0.88)	0.01 (0.79)	0.71 (0.81)	0.62 (0.84)	0.58 (0.85)	0.43 (0.83)	-0.01 (0.73)
$\Delta y_{t-2}$		0.16 (0.86)	0.04 (0.89)	0.04 (0.91)	0.38 (0.76)		0.17 (0.87)	0.08 (0.90)	0.06 (0.89)	0.38 (0.78)		0.47 (0.85)	0.37 (0.87)	0.36 (0.84)	0.57 (0.73)
$\Delta y_{t-3}$			0.59 (0.84)	0.46 (0.90)	0.41 (0.74)			0.52 (0.88)	0.32 (0.90)	0.41 (0.77)			0.65 (0.85)	0.43 (0.83)	0.41 (0.72)
$\Delta y_{t-4}$				1.02 (0.91)	<b>2.01</b> <b>(0.81)</b>				0.99 (0.90)	<b>2.02</b> <b>(0.85)</b>				1.31 (0.86)	<b>2.04</b> <b>(0.79)</b>



$\Delta y_{t-5}$	-0.03	-0.08	-0.10	-0.10	-0.12	-2.12 (0.91)	-0.07	-0.10	-0.09	-2.13 (0.94)	-0.02	-0.06	-0.08	-0.01	-2.30 (0.88)
$\bar{R}^2$	19.65	19.72	19.76	19.76	19.82	19.47	19.75	19.81	19.81	19.54	19.64	19.70	19.74	19.69	19.40
AIC	19.88	20.00	20.09	20.09	20.20	19.90	20.08	20.19	20.24	20.02	19.98	20.08	20.17	20.17	19.93
SIC	0.55	0.69	0.74	0.74	0.76	0.17	0.65	0.72	0.67	0.25	0.51	0.60	0.65	0.49	0.13
LM*	0.55	0.69	0.74	0.74	0.76	0.17	0.65	0.72	0.67	0.25	0.51	0.60	0.65	0.49	0.13
Wald*	0.70	0.65	0.75	0.75	0.48	0.98	0.93	0.96	0.94	0.69	0.59	0.55	0.72	0.73	0.54
White*	0.28	0.27	0.33	0.33	0.37	0.41	0.21	0.23	0.40	0.41	0.27	0.25	0.26	0.56	0.62
Jarque-Bera*															

\* probability to disprove the zero hypothesis, () standard error

For model 6, the fourth and fifth lags of the income change were affected by the consumption change. Rational time lag was based on adjusted  $R^2$ ,  $AIC$ ,  $SIC$ .  $AIC$ ,  $SIC$  criteria have maximum explanation potential of model 10.

$$\widehat{\Delta c}_t = 1119 - 0.37\Delta c_{t-1} + 0.05\Delta y_{t-1} + 0.45\Delta y_{t-2} + 0.48\Delta y_{t-3} + \mathbf{1.91}\Delta y_{t-4} - \mathbf{2.09}\Delta y_{t-5}$$

(1012) (0.19)      (0.72)      (0.71)      (0.68)      **(0.75)**      **(0.78)**

At the 5% importance level, income change of the previous four and five quarters affect the consumption change. Furthermore, at the level of 10% importance, all explanatory variables have an impact on the consumption change.

The residuals of model (10) have no series correlation, and it is normal and homoscedastic.

The income change lags have an impact on the consumption change. Explanatory variables have an impact on the consumption change. This rejects Hall's hypothesis that states the consumption change is unpredictable.

#### 4. Conclusion

Beginning from the second quarter of 2011, the real consumption per capital trend became more vertical, which shows that variables have rapid growth. The real consumption change per capita has no seasonal effect. But the result shows that the real income change in the third quarter is comparatively low compared to that in the first quarter.

By Hall's hypothesis there is no variable to explain the consumption change, it is determined to be exogenous. To test this hypothesis, the impact of income change on the consumption change was examined. Adjusted  $R^2$ ,  $AIC$ ,  $SIC$  criteria were used to determine the rational time lag, and a model with consumption change of one lag, and income change of up to five lags has been chosen.

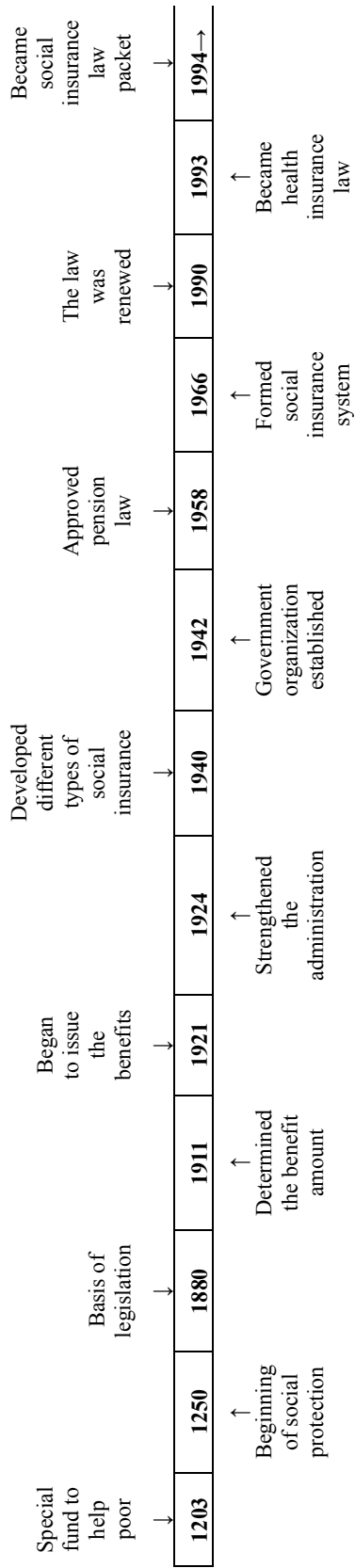
Income change lags have an impact on the consumption change. Income change increases the consumption after four quarters, and from the fifth quarter it has a decreasing effect on the consumption change.

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### Appendix 1. Social Insurance Development in Mongolia



Source: Erdene, S. (2013), "Social Insurance System: reform and direction" Academy of Management, Ulaanbaatar, Ph. D. dissertation, pp. 34-39 (in Mongolian)



# Social Safety Nets in Chile

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Felipe Allard

## 1. Introduction

Among public policies in the social sector, social protection is the main pillar, presenting its own characteristics derived from the particular problem that it intends to solve. Social protection is orientated toward guaranteeing the basic social and economic needs of all citizens. Social protection includes all measures that are aimed to build more equitable and inclusive societies, guaranteeing the coverage of basic needs for the population.

Social protection systems are nowadays characterized by a non-contributive pillar related to social assistance for all citizens or focalized on specific vulnerable groups and a contributive pillar or “social security.” The traditional concept of social security has led to the broader notion of social protection that considers three dimensions: 1) access to basic goods and services; 2) protection and prevention; 3) promotion of opportunities.

“The concept of *social protection* is a more general notion even when interpreted as the set of measures taken by public and private bodies to relieve households and individuals of the burden of a series of risks and needs.”<sup>2</sup>

## 2. Social Protection in Chile

The implementation of structural reforms prescribed by the US-based financial institutions during the 1980s, oriented to a neo-liberal approach of free market economy, was led by Chile in the early 1980s in Latin America. The reform included measures such as partial or full privatization of pension funds, and health care and social assistance systems. The authoritarian government in Chile at the time implemented most of these reforms under non-existent social dialogue or opposition, eliminating social solidarity and equity, increasing poverty and inequality to unseen historical levels. However, in the particular case of Chile, the successive democratic governments have revised and modified many of the distorting design measures of the neo-liberal model.

During the 1980s in Chile and the 1990s in the rest of South America, the role of the State was redefined, reducing fiscal spending and transferring the risks that used to be covered by the public sector to the individuals. Social services started to be progressively provided by private entities while the social spending decreased significantly. These

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<sup>1</sup> Consultant, United Nations Economic Commission for Latin America and the Caribbean (ECLAC)

<sup>2</sup> International Labour Office, Report of the Director-General Sixteenth American Regional Meeting (2006), “Decent work in the Americas for the Hemisphere, 2006-15”, p.14.

policies clearly intended to transfer the risks to the individuals, circumscribing the public sector to social assistance initiatives, focused on specific vulnerable members of the society.<sup>3</sup>

For example, in 1981 social security was reformed. The public pay-as-you-go pensions system, which had defined benefits and public administration, was closed to new entrants and was replaced by a fully funded individual system with defined contributions and run by private pension fund management companies called Administradoras de Fondos de Pensiones (AFP).

In 1990, a year in which Chile resumed its democratic process after being interrupted by the 1973 military coup d'état, the most significant shift was the transition from a social protection system focused on satisfying basic needs to one of guaranteed rights. Although a great effort was made to progress in social development in the first decade of the democratic governments of the Concert of Parties for Democracy (Concertación de Partidos por la Democracia), the majority of the public policies were directed toward dealing with poverty. It was only in the late 1990s that marked progress in eradicating poverty was seen through two consecutive governments.

The broad political and social achievements to which the democratic governments initially committed themselves in the 1990s were overcoming poverty, ensuring the transition from dictatorship to democracy, and building political trust in relation to the ability of the democratic government to manage the economy responsibly.

Since the 1990s, social protection in Chile has been characterized by an array of services and contributive and non-contributive policies designed to offer life-long state protection for all socio-economic groups. This system also considers policies which aim to offer universal access and strengthen the demand on social services focused on specific groups of the population.

During the Government of President Patricio Aylwin (1990-1994) and the following democratic governments several changes regarding social policies were introduced. These reforms aimed at improving social safety nets and increasing social investments. New actors became beneficiaries of social policies, which focused on specific groups such as youth, women, and those in extreme poverty, and new topics entered the analysis, focusing on matters such as public security, access to justice, gender, etc.

During the last decade governmental initiatives implemented a social model based on guaranteed social rights introducing various reforms in the health system (Universal Plan of Explicit Health Guarantees, AUGE), social security (Reforma Previsional and Chile Crece Contigo), unemployment insurance, as well as policies focused on reducing poverty. Social protection strategies have become the central pillar of the social policies which have two

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<sup>3</sup> Mesa-Lago, Carmelo (2008), "Social Protection in Chile: Reforms to improve equity", *International Labour Review*, Vol. 147, N° 4. p. 377.



main objectives: improve policies focused on different social groups and define more inclusive strategies with universal coverage from various risks.

In Chile an important instrument used for redistributing income and increasing welfare has been public social expenditures. Since the beginning of 1990s the Chilean State has increased annual social expenditures. During the period 1990-2006, expenditures increased by 400% in public health, by 370% in education, and resources for social protection (social security plus social assistance) has doubled. These expenditures were highly focused in low-income groups. In 1990, Social investments represented a total of 11.9% of the GDP, while in 2009 this had increased to 16.5%.<sup>4</sup>

Between 1990 and 2006, poverty in Chile decreased from 38.6% to 13.7% of the population. Extreme poverty, meanwhile, declined from 13% to 3.2%.

During the Government of President Michelle Bachelet (2006-2010), the Chilean safety net moved toward not only guaranteeing social rights to the population (including all social policies throughout the life cycle of families) but also extending these rights to social groups further away from poverty and institutionalizing them in the form of a social protection system called Red Protege. It is a regulated social protection system providing multiple services whose funding is secured by law.

In 2011 the Ministry of Social Development (Ministerio de Desarrollo Social) was created. The main objective of this reform was to improve the efficiency of policies aimed at reducing poverty and social development, creating a central coordination entity called the Executive Secretariat of Social Protection (Secretaría Ejecutiva de Protección Social). During the same year the Chilean government established a non-contributive transfer called Bono de Apoyo a la Familia aimed at reducing extreme poverty.

Chile's democratization process helped increase awareness about the desirability of shifting from a need-based to a right-based approach to social protection, with guaranteed basic social rights. Gradually access to benefits was universalized, including areas such as health, pension, unemployment, childcare, and primary education. "The temporary approach was turned into a social protection floor perspective, which makes social protection a full and permanent component of the development strategy for inclusive growth."<sup>5</sup>

Nevertheless, Chile is one the countries with the highest income concentration in the world, and this not only affects the extent to which the benefits of growth are passed on to the population, but also may affect governance and even have negative effects on growth itself. Furthermore, inequality has recently increased in most countries of Latin America,

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<sup>4</sup> Foxley, Alejandro (2010), *Sustaining Social Safety Nets Critical For Economic Recovery*, Washington D.C., Carnegie Endowment for International Peace, p. 49.

<sup>5</sup> International Labour Organization (2011) "Social Protection Floor for a Fair and Inclusive Globalization", Report of the Advisory Group chaired by Michelle Bachelet convened by the ILO with collaboration of the WHO, Geneva, p. 13.

and only decreased slightly in just a few countries, remaining as a social problem in the region.

## **Pensions**

The 1980 reform (which was, as mentioned above, carried out without any public debate) imposed a pension system managed by individual capitalization funds. Mandatory individual savings accounts constitute the basic pillar that determines the value of pensions, equivalent to the accumulated individual savings in the life cycle. A complementary pillar may be added, funded by the government for disability pensions and to cover extremely poor people.<sup>6</sup>

A short transition period at the time of the reform was granted to allow insured citizens to decide whether to stay in the public system, controlled by the Institute of Social Security Standardization (Instituto de Normalización Previsional), or move over to the new private system. However, all new entrants to the labor force were obliged to affiliate with one of the private pension fund management companies (AFP). By 2006 only 9% remained in the public system. The armed forces, which implemented the reform, excluded themselves from it, and have a separate scheme with better pensions, mostly financed with public funds.<sup>7</sup>

Changes to the private system, even though not substantial, were introduced in July 2008. Before that date there were two main programs dealing with elderly poverty in Chile – the minimum contributory pension guarantee, which provided a floor for pensions in the case of individuals who contributed for at least 20 years, and the Social Assistance Pensions Program for poor individuals with no pension entitlements. The reform replaced the minimum pension and social assistance pension program with a single means-tested pension. The new scheme guarantees that all elderly people in the 3 lowest income quintiles receive a basic pension regardless of their contribution history. This program provides old age and disability subsidies financed by general revenues. Those who have made no contributions are entitled to the Basic Solidarity Pension (PBS) at age 65. Individuals who made contributions but are going to receive a pension below a certain threshold are entitled to the Pension Solidarity Complement (APS). The new system is expected to increase incentives for workers to join the formal sector and therefore improve contribution densities. The integrated approach reduces incentives in favor of informal work because contributions are not taxed at a 100% marginal rate.<sup>8</sup>

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<sup>6</sup> Foxley, Alejandro (2010), *Sustaining Social Safety Nets Critical For Economic Recovery*, Washington D.C., Carnegie Endowment for International Peace, p. 39.

<sup>7</sup> See *Mesa-Lago, Carmelo (2008)*.

<sup>8</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C., The World Bank, p. 219-220.

Chile still spends 5% of its GDP on pensions, including benefits from the old scheme, minimum benefit guarantees and pensions for the armed forces.

The superintendency of AFPs regulated and supervised the private system until 2008, but various regulatory and supervisory functions were assigned to other entities.

In Chile contributors choose among five different funds. Approximately 0.6% of them retire each year. At the time of retirement they may buy a nonadjustable annuity or they may be exposed to higher risks in case they choose to stay in a scheduled withdrawal scheme.<sup>9</sup>

About 60% of the labor force contributes regularly in the pension system but the private system was and still is lacking in solidarity, since minimum pensions and non-contributory pensions are partly and entirely financed by the State, respectively.

AFPs exercise considerable power because they manage pension funds worth a considerable percentage of Chile's GDP (64% of GDP in 2007), and have succeeded in postponing any fundamental reform for almost 30 years.<sup>10</sup> An option that is currently being studied is to create a public owned AFP that may introduce higher levels of competitiveness to this privately run market, and is considered the first step for greater public involvement in this matter.

## **Employment and Education**

Unemployment insurance is a very important instrument in the field of social protection. In 2002, Chile introduced an unemployment insurance that combines social insurance with self-insurance. The inclusion of unemployment insurance is mandatory in the case of workers who initiated a work relationship in the private sector from October 2002 onward, and on a voluntary basis in the case of workers with work contracts entered into prior to that date.

Unemployment contributions are split between individual accounts (Individual Unemployment Accounts) and a common solidarity account (Solidarity Unemployment Fund, Fondo de Cesantía Solidario). The Individual Unemployment Account is financed with contributions of each worker and his or her employer. The common solidarity fund is financed with contributions from employees, employers and the government.

Even though the income protection system includes an individual unemployment savings account component, benefit payments in the case of a job loss take the form of gradual withdrawals that stimulate payments under unemployment insurance. Therefore, the unemployment savings accounts, managed by an Unemployment Fund Administrator

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<sup>9</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C., The World Bank, p. 195.

<sup>10</sup> Mesa-Lago, Carmelo (2008), "Social Protection in Chile: Reforms to improve equity", *International Labour Review*, Vol. 147, N° 4, p. 387.

(which is selected for this purpose through a public tender), are not paid in addition to the unemployment insurance.

Withdrawals of funds, which are limited to 2 times every 5 years, are first made from the individual accounts in order to stimulate reemployment. These withdrawals are activated by the worker leaving his job for any reason, as long as they have made a certain number of payments (twelve in the case of open-ended contracts and six in the case of fixed-term or specific works/services contracts). The level of the benefits depends on their past earnings with a replacement rate that declines with income. These benefits consist of monthly payments that begin at 50% of the workers wage and are reduced to 20% from the seventh payment on. Withdrawals from the Solidarity Unemployment Fund are triggered by the exhaustion of resources in the individual account. The workers eligible to use this instrument are only those who had open-ended contracts and are fired due to “company needs” or “force majeure”, and in the case of fixed-term workers or workers hired for specific works and services, after their contracts have expired). To be eligible, beneficiaries must certify that they are unemployed and actively searching for a job. The benefits of this fund are limited to a maximum of five payments, consider an initial replacement rate of 50% that is reduced to 30% of the worker’s wages by the fifth payment. Exceptionally, if the unemployment rate is above the trend rate, there may be two additional payments with replacement rates of 25% each.

The individual account finances the liabilities with the worker. Employers reduce their severance obligations because the severance pay is partly replaced by the unemployment insurance.<sup>11</sup> The employer’s contribution to the worker’s individual account may be deducted from the amount due to workers with open-ended contracts as a severance payment for years of service, if the work relationship was terminated in accordance with Article 161 of the Labor Code (“company needs”). Every year employers deposit around 20% of the severance payments they must guarantee for workers upon termination of their contracts into their Individual Unemployment Accounts. Thus, it is understood that the obligation of workers and employers to contribute to Individual Unemployment Accounts expires after 11 years of a work relationship with the same employer (maximum period of severance payments per year of service). However, employers are still obliged to contribute to the common solidarity fund until the end of the work relationship.<sup>12</sup>

The existence of individual unemployment savings accounts can increase job search efforts because savers can keep for the future any savings they do not use to finance their consumption while unemployed. Any remains in the unemployment savings account at the time of retirement can be taken as a lump sum or used to increase their pensions. In Chile,

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<sup>11</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C.,The World Bank, p. 262.

<sup>12</sup> Superintendencia of Pensions (September 2010), “Unemployment Insurance in Chile”, Printed by Grafica LOM, Santiago, p .13.

workers with higher balances in their individual accounts have shorter periods of unemployment.

In Latin America the main problem relates to the high levels of informality. Chile has the lowest level of informal employment in the region, at 37%. A problem related to this matter is that the majority of the workers contribute to the social security system less than 50% of the time. In Chile the average is 47.4% of total years worked.<sup>13</sup>

Low paid workers are sometimes tempted to work in the informal sector in which they can evade paying taxes and contributing to social insurance, and employers are tempted to elude statutory protections such as minimum wages and job stability. Low paid workers usually attribute low value to future consumption compared with consumption today, which reduces their interest in deferred benefits that come with formal sector employment such as pensions.<sup>14</sup>

It is necessary to generate labor market policies, such as unemployment insurance, together with active policies to create instruments that help the unemployed to find a job immediately.

Active labor market policies consist of interventions in the labor market designed to combat unemployment and raise workers' income. The main instruments are programs for direct and indirect job creation, occupational training, employment services and encouragement of self-employment and small firms.<sup>15</sup>

It is important to promote human capital in order to increase individuals' earnings capacity and reduce their exposure to risks such as disease and unemployment. Better educated and healthier individuals are less likely to become unemployed or sick.

In order to certify skills of workers who have not completed formal schooling the program Chile Califica, funded by the government and the World Bank, may help toward overcoming job search constraints, especially for the poor.

Contributory social insurance should be open to informal sector workers with adequate financial and institutional incentives, giving access to all workers to the same social insurance system. In order to expand social security it is necessary to involve public subsidies because many workers in low productivity jobs do not have enough savings capacity to cover the full cost of the risks against which they need to be insured. Eligibility for these subsidies should be based on earnings and savings capacity without distinguishing whether these are formal or informal sector workers.

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<sup>13</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C., The World Bank, p. 97-98.

<sup>14</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C., The World Bank, p. 311.

<sup>15</sup> Weller, Jürgen, Ed. (December 2009), *Regulation, Work Protection and Active Labour-Market Policies in Latin America*, Santiago, ECLAC, p. 35.

A subsidy that is limited to the informal sector is equivalent to a tax on formal work and can increase the share of informal work in the economy. A subsidy limited to formal sector workers would exclude unskilled and low-income workers and would likely be regressive.<sup>16</sup>

These unemployment subsidies and other safety net programs should be temporary in order to avoid creating incentives for long periods of unemployment, increasing costs and compromising sustainability of the unemployment programs.

For workers and households in extreme poverty the social safety net must facilitate access to better jobs including cash or in-kind transfers. In Chile unconditional cash transfers targeting poverty include family subsidies through the Subsidio Único Familiar.

Middle-income countries have sought ways to develop links with education, vocational training and employment services such as the beneficiaries of Chile Solidario, a successful human development conditional transfer program.

## **Health**

In relation to health systems, the formal sector workers in Chile must contribute a fixed 7% of their income. The insurers offer benefit packages which are standardized taking into account the worker's absolute financial contribution and health risk factors. Although insurance is mandatory, this system originally resulted in some individuals having insufficient financial protection against health care costs.

The problem under this competition model is the risk selection made by the private insurers. In order to maximize profits, insurers deliberately select enrollees who are least likely to need health services. Unless there is a public insurer of last resort, some high risk individuals tend to remain uninsured. In Chile, the vast majority of the elderly (high-risk individuals) are enrolled with the public insurer FONASA.<sup>17</sup>

To correct this problem, in 2005 the government introduced minimum health guarantees creating a Universal Plan of Explicit Health Guarantees (AUGE), following a right-based approach to public policy. This Plan sets out detailed assurances regarding access, opportunity, quality and financial protection to improve and extend health care. Chileans are granted the right to access health care in order to face the listed diseases that are the main causes of morbidity and mortality in the country within a certain period of time; with maximum co-payments and quality standards guaranteed by the state.

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<sup>16</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C., The World Bank, p. 52.

<sup>17</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), *From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean*, Washington D.C., The World Bank, p. 153-154.

### 3. Coordination of Agencies for Social Protection

Chile has aimed to coordinate agencies and networks in order to harmonize and coordinate social protection efforts and has made substantial progress toward ensuring social rights for people in need. Social assistance focused on covering the basic needs of the poor has been replaced by a social protection entitlement approach. The set of programs that guarantee social rights are coordinated by a social protection network called Red Protege (Protection Network). This involves different programs for every basic social right, with one common denominator, the intervention unit is the household. Moreover, coverage has a life cycle approach, interventions prioritize enhancement over assistance, and the law secures social rights.<sup>18</sup>

The first program to become part of this network was Chile Solidario. Initially, in 2003, this program focused on poverty reduction, but its role has grown over time to cover other people at risk. This program, which provides benefits for only two years, was created to build beyond cash transfers to strengthen overall social protection for the most vulnerable, ensuring families learn how to make effective use of the social protection network. The program's conditional cash transfers are temporary catalysts in order to help establish permanent links between the most vulnerable households and the broader permanent social protection network. They are guided to a wide range of benefits and supporting services, such as housing, child benefits, training and labor market inclusion programs, that can potentially help them to escape social and economic exclusion.<sup>19</sup>

Components involve income security as well as access to essential services for all household members. An example is Chile grows along with you (Chile Crece Contigo), a childbirth program launched in 2007, which was designed to protect pregnant women and children under four years old. This program recognizes the critical role that living conditions play in the early years in influencing social determinants of health.

The network has gained legitimacy and consensus through a long and intensive political process strengthened with a legal framework backing the program. The institutional process began with discussions and analysis of social protection reform in Presidential Advisory Committees. There was a degree of technical and political agreement among relevant stakeholders when the executive branch submitted the bills to the National Congress for approval. The law also secures Red Protege funding, with the legal framework that supports the programs establishing the financial commitment required for their implementation.<sup>20</sup>

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<sup>18</sup> Social Protection Floor for a Fair and Inclusive Globalization, Report of the Advisory Group chaired by Michelle Bachelet convened by the ILO with collaboration of the WHO, International Labour Organization 2011, p. 52.

<sup>19</sup> Ribe, Helena, David Robalino and Ian Walker, (2012), From Right to Reality Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and The Caribbean, Washington D.C., The World Bank, p. 337.

<sup>20</sup> Social Protection Floor for a Fair and Inclusive Globalization, Report of the Advisory Group chaired by Michelle Bachelet convened by the ILO with collaboration of the WHO, International Labour Organization 2011, p. 52.

Since 1979, the main instrument used to focalize resources on families that need to be assisted with social programs has been the Ficha CAS, (file card based on the CASEN socio-economic survey) that changed its name to Ficha de Protección Social (Social Protection File Card). Even though it has suffered changes it has always been intended to measure socio-economic levels of living and difficulties and stands as a good example of how technology and knowledge can help promote social inclusion.<sup>21</sup> Modifications to the CASEN socio-economic survey announced by the Chilean Government that will likely be implemented in 2014 should assure the correct identification of the individuals and families that should be beneficiaries of social protection.

As an example of the Chilean safety net, we can mention the programs delivered by the National Board for Students Aid and Scholarships (Junta Nacional de Auxilio Escolar y Becas, JUNAEB) that assist children and young students in need that are living in vulnerable conditions. Among the services offered to the beneficiaries of the program are education scholarships, which has historically been one of the main objectives of the program.

In 1990s, the democratic governments reestablished the health program for students, and special programs for public summer camps and student housing. Between 1990 and 2000 public funding was doubled giving coverage to 1.5 million beneficiaries of its school feeding program. In 2002, the United Nations recognized this program as one of the top programs in world.

The services offered by JUNAEB include programs on nutrition, health, housing, recreation, education, scholarships and others.

An effective model to tackle social exclusion implies a system of cross sectorial management that includes identification of all benefits of the social protection network, formal agreements between institutions that provide services to the same beneficiaries and the sharing of targeting and beneficiary selection systems.<sup>22</sup>

During 2012, an Ethical Family Income Bill came into force. This new law creates a system of financial support and bonuses for families living in extreme poverty and a subsidy for working women.

The Ethical Family Income project is aimed to assist 640,000 Chileans who live in extreme poverty and includes, in case of being eligible, financial support to the emerging middle class, benefiting over a million families in the country.

This project, which has an estimated cost of US\$400 million a year, is based upon three pillars: 1) Payment of a basic dignity award in which everybody living in extreme poverty is automatically eligible; 2) Duties (individuals living in extreme poverty will be awarded in case they fulfill certain responsibilities, such as, taking their children under 6

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<sup>21</sup> Social Protection Floor for a Fair and Inclusive Globalization, Report of the Advisory Group chaired by Michelle Bachelet convened by the ILO with collaboration of the WHO, International Labour Organization 2011, p. 85-86.

<sup>22</sup> From Right to Reality Incentives, Labor Markets, and the Challenge of Social Protection in Latin America and The Caribbean, p. 339-340.



years old to the health clinic for check-ups (Control Niño Sano program) and if their children record at least an 85% attendance rate at school; 3) Awards for Achievements, in which the 30% of families with the lowest incomes in the country are eligible in case they achieve certain goals related to education and employment. The School Achievement Award is paid to families if their children are ranked among the top 15% tier in their year (a transfer of about US\$100) or approximately US\$60 if they are in the top 30% tier. The second award is The Female Employment Subsidy, paid to working women aged between 25 and 59 years old, from 1,380,000 low-income families in which the State pays an extra 20% to supplement the woman's wages, plus a 10% bonus to the employer in order to incentivize companies to employ women. The supplement to women's wages can last a maximum of four years and the bonus paid to the employer a maximum of 24 months.<sup>23</sup>

#### Examples of the Ethical Family Income Project

##### • Family A: 2 adults + 2 children (figures in Chilean pesos)

	Woman	Man	Boy	Girl	Monthly total
Dignity: basic award	\$6,000	\$6,000	\$6,000	\$6,000	\$24,000
Dignity: family award					\$13,000
Duties			\$8,000	\$8,000	\$16,000
				<b>SUBTOTAL</b>	<b>\$53,000</b>
Working woman *					\$34,000
				<b>MONTHLY TOTAL</b>	<b>\$87,000</b>
School Achievement Award**	\$50,000 for top 15% tier of pupils in their year group				
	\$30,000 for second 15% tier of pupils in their year group				

\*Based on minimum salary of \$182,000.

\*\*Award paid once a year to the top 30% of eligible pupils.

##### • Family B: 1 woman + 2 children (figures in Chilean pesos)

	Woman	Boy	Girl	Monthly total
Dignity: basic award	\$6,000	\$6,000	\$6,000	\$18,000
Dignity: family award				\$13,000
Duties		\$8,000	\$8,000	\$16,000
			<b>SUBTOTAL</b>	<b>\$47,000</b>
Working woman *				\$34,000
			<b>MONTHLY TOTAL</b>	<b>\$81,000</b>
School Achievement Award**	\$50,000 for top 15% tier of pupils in their year group			
	\$30,000 for second 15% tier of pupils in their year group			

\*Based on minimum salary of \$182,000.

\*\*Award paid once a year to the top 30% of eligible pupils.

Source: Government of Chile (May 2012)

<sup>23</sup> <http://www.gob.cl/english/government-information.htm>

#### **4. Macroeconomic Effects**

In Chile, social policy is built on the basis of fiscal discipline. Unlike the second half of the 1980s, when the benefits of economic growth were used to reduce taxes, in the beginning of 1990 a tax reform was passed in order to reverse the tax cuts of previous years, fiscal discipline was emphasized, and the proceeds were directed toward increasing social spending.

Maintaining and strengthening social safety nets depends on solid macroeconomic management throughout both good and bad times. Good macroeconomic policies allow countries to implement countercyclical social policies which has been Chile's case in the last two decades. A high level of international reserves and of public-sector savings make it possible to finance significant fiscal stimulus efforts without reducing social expenditures.<sup>24</sup>

A particular example of these good practices relates to the Ministry of Finance's rule of structural surplus of 1% of GDP on total fiscal expenditures, on an annual basis, which allowed the government to spend approximately US\$5.5 billion on social protection during the last financial crisis.

Investment in social development has effects as a macroeconomic stabilizer and has a positive impact on human development and productivity. "Social protection has helped to stabilize aggregate demand in times of crisis and to increase resilience against economic shocks, contributing to accelerate recovery and more inclusive and sustainable development."<sup>25</sup> An effective social protection system is necessary to complement economic growth patterns based on income and asset concentration and social exclusion that threaten social cohesion and political stability. In order to maximize their impact, "social protection measures must be linked appropriately to a wider macroeconomic framework including fiscal and monetary policies."<sup>26</sup>

#### **5. Conclusions and Recommendations**

The two main aspects that influenced change from a need-based to a right-based approach to social protection in Chile was the existence of a more informed citizenry, aware of its rights and demanding of their enforcement, together with the socio-economic growth experienced by Chilean society in a short period.

The above-mentioned aspects have led to a political discussion of the future role of the State and its greater involvement in these matters. The main positions that collide in the Chilean political arena are between those who believe that the government's key focus

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<sup>24</sup> Foxley, Alejandro (2010), *Sustaining Social Safety Nets Critical For Economic Recovery*, Washington D.C., Carnegie Endowment for International Peace, p. 35

<sup>25</sup> International Labour Organization (2011) "Social Protection Floor for a Fair and Inclusive Globalization", Report of the Advisory Group chaired by Michelle Bachelet convened by the ILO with collaboration of the WHO, Geneva, p. XXII.

<sup>26</sup> International Labour Organization (2011) "Social Protection Floor for a Fair and Inclusive Globalization", Report of the Advisory Group chaired by Michelle Bachelet convened by the ILO with collaboration of the WHO, Geneva, p. 52.

should be aiming for economic growth against those who believe that governmental authorities should prioritize dealing with inequality by enhancing income distribution. In any case, in the near future the State undoubtedly will need to increase its regulatory capabilities and play an active role in productive development.

Chile has been successful in coordinating agencies and ensuring the most vulnerable families learn how to make effective use of the social protection network through the Chile Solidario program. The current discussion in social protection matters in Chile refers to the CASEN socio-economic survey, the main instrument used to focalize resources on families that require social assistance, in accordance with the necessities reflected on their Social Protection File Card. The survey must take into consideration the opinion of the main political actors and guarantee the veracity of the gathered information, adding new variables that can help identify the necessities and socio-economic level of the different members of the Chilean society.

There is an absence of strategic planning related to identifying the number and characteristics of human resources required in the productive sector, and a lack of information available in order to establish the correct equilibrium between the specialties that higher education institutions provide and the present and future needs of the labor market.

Developing human resources is a key factor in order to face globalization that places a premium on high skills that make workers more competitive, increasing income inequality between the highly skilled minority and the rest.

We believe it would be convenient to coordinate enterprises, workers unions and academia, and create a national agency that can help identify the areas in which the country has comparative advantages, investing in the formation of new productive sectors and increasing the competitiveness of the existing sectors, assuring the presence of adequate human capital through capacity building.

It is necessary to encourage employers and employees in order to formalize their working relationships. The worker should not receive a lower net income after ending his period as a beneficiary of an unemployment social protection instrument. He or she should be able to increase their expectations of future income levels, through the development of capacity building initiatives that improve working skills associated to new jobs. At the same time, informal working relationships should have higher statutory penalties.

In relation to labor market regulations, an interesting option to study is Denmark's "flexicurity" model which combines flexible labor market regulations (allows firing workers when necessary and regards adequate collective bargaining as an efficient and effective instrument of labor negotiation), protection for the unemployed (with generous benefits) and active labor market policies in order to facilitate prompt and productive reemployment for those who lose their jobs.

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# **Social Protection as an Entry Point to Inclusive Growth in Myanmar**

Khine Tun<sup>1</sup>

## **1. Introduction**

Given significant political progress and a series of economic reforms, Myanmar is anticipated to become a new tiger in emerging Asia. The rapid transformation process is vigorously supported by the international community. Investors all over the world are showing their interest in tapping this promising market located in the midst of the growth region. Economic sanctions set by the western countries have been gradually removed. In these circumstances, the country's economy is forecast to grow to four times the current US\$50 billion to US\$200 billion by 2030 if prerequisites such as infrastructure and labour productivity improvements are effectively accomplished to achieve an annual GDP growth rate of 8 percent (McKinsey 2013).

However, growth alone is insufficient, but should also be inclusive. Inclusive growth, according to the Asian Development Bank (ADB), focuses on a subset of a traditional growth episode. In order to achieve inclusive growth, economic growth is a necessary condition but not sufficient. Therefore, it is necessary to determine what characterizes growth episodes that qualify as inclusive. There are two dimensions suggested by the ADB – one focuses on process and one focuses on outcomes. Inclusive growth focussed on process is based on inputs from a large number of people or allows equal opportunity to all people who wish to participate in growth process. On the other hand, inclusive growth focussed on outcomes is based on sharing the benefits to a large number of people or redistribution to those who are naturally excluded from direct benefits of growth.

Social protection which strengthens social resilience is a channel to realize inclusive growth. Social protection, a policy and programming framework aiming to reduce socioeconomic risks and people's vulnerabilities with the objective of assuring equitable human development, supports fulfilment to both dimensions of inclusive growth – process and outcomes. For example, a social safety net scheme as a part of social protection intends to provide the poor with a set of government programmes such as food stamps, welfare payments, free health clinics, and unemployment insurance which is a certain type of redistribution of growth outcomes. On the other hand, social protection intervenes for the benefit of the poor providing opportunities for access to education, healthcare, employment, market, infrastructure, financial resources and other rights that promote the capacities of the poor and thus their potential to participate in the growth process.

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## **2. Social Protection Mechanism in Myanmar**

One achievement to have come out of the bitter experiences of the colonial regime in Myanmar is a well-established legal system. Regarding social protection, although a proper law was not yet enacted at that time, similar legal frameworks such as the Workmen's Compensation Act 1923, the Trade Dispute Act 1929 and the Payment of Wages Act 1936 were active to protect individual labours and their dependents' benefits. All these three references have been applied throughout the period after independence for labour-related legal considerations in Myanmar.

Among different social protection schemes, social security has been the most significant in Myanmar since pre-independence. A two-year economic plan named the Sorrento Villa Plan of 1947 included labour affairs that indicated that social welfare insurance systems such as unemployment insurance and social insurance would be put in place. A social security act to implement the social security plan was then drafted by the ILO and enacted on 22 October 1954, and the Social Security Board (SSB) chaired by the Minister for Labour was established on 26 April 1955. The SSB of Burma (the former name of Myanmar) then joined the International Social Security Association (ISSA) to carry out the tasks in accordance with the international standards.

The Socialist government then took power and drew up a 20-year long term plan to expand the social security scheme in 1971/72, aiming at expansion of coverage of at least 4 townships per annum. After 1988, the military government enlarged the social security board by newly establishing regional branches in other cities and small towns.

The Social Security Act encourages industrial establishments where at least 5 persons are employed to join the scheme. The industrial establishments include not only manufacturing factories but also service industries including shops. Employers and management concerned are responsible for making the necessary arrangements to insure their workers with the Social Security Board. Persons working either permanently or temporarily in designated establishments such as salaried workers, daily-waged workers, piece-rate workers and apprentices are eligible to be covered by the scheme. The scheme was first introduced in the Rangoon (the former name of Yangon) area and gradually extended throughout the country. There were only 15 townships covered by government's social security scheme in 1956-60, and this increased to 82 by 1990, 106 by 2000 and 110 by 2008.

However, it still falls short in providing coverage to a total of 330 townships in 14 States/Regions throughout the country. Only 110 townships from 13 States/Regions (except Chin State) are so far covered by the government's social security scheme. Total coverage is just 33 percent of the total number of townships. The scheme has not been extended any further since 2008.

In these 110 townships where the social security scheme operates, only the following industries are eligible to enjoy the social security act:

- (a) Industrial establishments in which at least 5 persons are employed;

- (b) Establishments covered under the shops and Establishments Act (1951);
- (c) Railways under the Myanmar Railways Enterprises;
- (d) Public industrial and transport establishments under the Union Government or a local authority;
- (e) Ports / Mines / Oilfields/ Docks
- (f) The Ministry of Labour; and
- (g) Any other establishments as may be notified by the competent authority from time to time

Apart from the limited coverage of industries, only those persons working permanently or temporarily in the covered establishments as salaried workers, daily-rate workers, piece-rate workers and apprentices can benefit from the government's social security scheme.

Therefore, as shown in Table (1), the coverage of the social security scheme is extremely small, at a little over 2 percent of the total labour force or less than 1 percent of the total population, according to the statistics of 2008 in which the latest coverage survey was conducted.

Table 1. Coverage of Government's Social Security Scheme (by population)

<b>Description</b>	<b>Count</b>
Total Estimated Population	57,370,000
Total Labour Force	27,000,000
Insured Workers	566,665
Insured Workers (% of total labour force)	2.10%
Insured Workers (% of total population)	0.99%

*Source:* Data from Population Department and Department of Social Welfare

Coverage of far less than 1 million insured workers, compared to other economies such as Thailand with more than 9 million insured workers, shows the challenges faced by the country's social security system.

Apart from that social security scheme, assistance measures include guaranteeing access to sufficient resources for food and shelter and to promote health and wellbeing for the population at large. The pension scheme, social welfare, labour welfare and insurance scheme are the currently applied measures in Myanmar's social security programmes. There is no unemployment social benefit scheme in Myanmar.

### **Pension Scheme**

In Myanmar, only public servants are covered by the proper pension scheme provided from the government budget. Since independence in 1948, the country has been providing pensions to the retired State service personnel. In 1956, it approved family pensions in addition to the pensions of staff members. In 1973, the pension service that could be enjoyed for up to a maximum of 30 years was increased to 42 years, and the family pension service was also extended from 10 to 15 years. In 1977, a temporary cost of living allowance (CLA) was provided on account of the country's economic conditions. In 1988, additional payments on top of pensions

were approved. In 1989, the country again added temporary payments and a CLA to the original pension rates. Moreover, it revoked the policy that indicates a pension rate of not more than 600 kyats (about US\$7 at the market exchange rate of that period). In 1993, it increased pension rates by 25 per cent. In 1994, it increased family pension rates from half to three-fourths of the pension rates of retired State service personnel, and increased the term of family pensions from 15 years to life time. In 2000, it doubled pension rates. The latest increase of pension rates which meet contemporary salaries of in-service staff are granted to the retired government staff by the new government as from July 2011.

In the private sector, those employees who contribute to the government's insurance scheme can benefit from a permanent disability pension and survivors' pension. The permanent disability pension is directly paid to the beneficiary based on the percentage of loss of earning capacity while the survivors' pension is paid to dependents when the case of death is due to employment injury.

### **Social Welfare**

The government is implementing a variety of social welfare measures including a child welfare service, youth welfare service, women welfare service, care of the aged, rehabilitation of the disabled, and resettlement and rehabilitation of vagrants.

These social welfare activities are in fact initiatives of the government but funding sources by the government are far from adequate to meet even the minimum requirements. Therefore the extent and quality of services are completely dependent upon domestic and internal donors. For example, the Vocational Training Centre for Women, which aims to provide vocational training to girls who are in need of care and protection, requires an expenditure of 150 kyats per head for daily meals. Out of this amount of expenditure, only 37 percent is contributed by the government while 57 percent comes from donors and 6 percent comes from the beneficiaries' income earned from likely on-the-job training such as hand waving, sewing, embroidery, upholstery making and laundry services.



Table 2. Social Welfare Activities in Myanmar

No.	Type of Social Welfare	Beneficiaries	Services	No. of Service Centres
1.	Child Welfare Service	Orphans and abandoned children in the 0-5 age group	- Institutional care - Pre-primary education - Health & nutrition - Service for adoption under the Registration of Kittima Adoption Act	6
2.	Youth Welfare Service	Children who are in need of protection	Vocational training	8
3.	Women Welfare Services	Destitute women in the 18 and above age group	- Institutional care and counselling - Vocational training	2
4.	Care of the aged	Those destitute or with no-family members to depend upon, in the 60 and above age group	- Homes for the aged - Institutional care - Healthcare - Religious activities	33
5.	Rehabilitation of the disabled	Single or multiple disabled children or adults	- Special education for the 6-12 age group - School for the blind for the 6-12 age group - School for the deaf for the 6-18 age group - Vocational training in tailoring, carpentry, off-set printing, silk-screen printing, massage and photography for the 18-45 age group	4
6.	Rehabilitation for Social Outcasts	Those who have been ostracized due to their functions in life	- Resettlement of ex-lepers and providing for their requirements - Placement in suitable jobs and opening of Youth Centres and Voluntary Primary Night Schools for the benefit of their children	3 villages

*Source:* Department of Social Welfare

### **Labour Welfare**

During the past half decade, labour welfare for those workers in private sector was more or less neglected by the authorities. The 1962 Trade Union Act also totally banned labour strikes and formation of labour unions in the country. Communicating with the International Labour Organization (ILO) or International Trade Union Confederation (ITUC) was defined as an offense. The new Labour Organization Law enacted on 11 October 2011 which overturned the Trade Union Act allowed for the formation of unions and for the workers to legally go on strike in

protest for workers' rights. Currently, the parliament has drafted the Minimum Wage Law with the aim of meeting the essential needs of workers and their families.

### Insurance Scheme

Myanmar adopted a social insurance system which covers certain groups of employees of state enterprises, certain types of civil servant, and temporary and permanent employees of public or private firms with five or more workers in industry and commerce or in specified industries and services such as railways, ports, mines, and oilfields. Self-employed persons, workers in private shops and establishments with less than five employees, construction workers, agricultural workers, and fishermen are excluded from the social insurance system. The types of social insurance scheme are shown in Table (3).

Table 3. Social Insurance in Myanmar

No.	Type	Source of Fund	Necessary Qualified Period	Benefit
1.	Free Medical Care			
1.1	Sickness benefit	- 2.5% of employee's wage contributed by employer - 1.5% of employee's wage contributed by employee itself - Government subsidies		- Primary Care in Clinics - Secondary Care in Workers' Hospitals - Tertiary Care with referral linked system to specialist hospitals
1.2	Maternity benefit			
1.3	Employment Injury benefit (temporary & permanent)			
2.	Cash Benefits			
2.1	Sickness benefit		4 months	50.00% of wage
2.2	Maternity benefit		6 months	66.67% of wage
2.3	Funeral grant		1 month	40,000 kyats*
2.4	Temporary disability benefit		1 month	66.67% of wage
2.5	Permanent disability benefit		1 month	Loss of earning capacity
2.6	Survivors' benefit		1 month	66.67% of wage

Source: Department of Relief and Resettlement

\* About US\$42 at the prevailing average market exchange rate as at June 2012

Both contributions and benefits of the social insurance system are administered by the Social Security Board of the Ministry of Labour. As shown in above table, free medical care and cash benefits are financed by contributions from employees, employers and the state. Employers and employees have to pay their contributions according to 15 wage classes: from the lowest class of 1-4,000 kyats to the highest class of 30,000 kyats and above. The state subsidies especially go to the capital expenditures such as building the hospitals, clinics, offices and purchasing medical equipment, vehicles, furniture and office materials. Accordingly, the social security fund covers three separate accounts: General Insurance Account, Employment Injury Account, and Administrative Expenditure Account.

Besides these types of contributory social protection for which the Ministry of Labour (now the Ministry of Labour, Employment and Social Security) is responsible, there is non-contributory social protection in Myanmar. The Department of Social Welfare under the Ministry of Social Welfare, Relief and Resettlement gathers those children in need of protection and accepts those children sent by juvenile courts to provide temporary care. Training Schools for Boys and Training Schools for Girls train and take care of children for holistic development through formal education, non-formal education and vocational training. Moreover, these children are ensured reintegration into society and reunification. In providing formal education, boys and girls are compulsorily provided with primary education, and made to continue to secondary education and above subject to their interest and qualification. Those who take no interest in continuing their studies are transferred to the vocational training schools and provided with training such as agriculture and livestock breeding, hair dressing, cane-work and vehicle servicing.

Likewise, the Women's Development Centre, Vocational Training Centre for Women and Care Women Centre target females who are in need of care and protection, are facing social problems, or have returned from abroad after experiencing problems such as human-trafficking. These women are provided with institutional care, healthcare, non-formal education, vocational training such as hand weaving and laundering, counselling and placement.

Myanmar social welfare highlights the disabled including the blind and deaf. The objectives of taking care of the disabled are to provide education and vocational training, to let them stand on their own with their knowledge and skills, to facilitate their livings in the society, to be able to perform their daily activities independently, and to eliminate depression related to their disability and build self-confidence. Social welfare services and centres are shown in Table (4).

Table 4. Social Welfare Services and Centres provided by the Government (2011)

No.	Particulars	No. of Centres	No. of Beneficiaries
1	Training School for Boys	7	1,259
2	Training School for Girls	2	377
3	Residential Nurseries	6	222
4	Women's Development Centre	2	164
5	Vocational Training Centre for Women	4	264
6	Care Women Centre	2	85
7	School for Blind	2	182
8	School for Deaf	1	195
9	Vocational Training School for Adults Disabled	1	200
10	School for Disabled Children	1	175
11	Home for Disabled Children Care	1	23

Source: CSO, Statistical Yearbook 2011

Besides government social welfare service centres, UN agencies as well as local and international non-governmental organizations (LNGOs & INGOs) and civil society organizations (CSOs) also participated to achieve social resilience to some extent. For example, the programmes

such as the Human Development Initiative, Self-Reliance Grouping, and Microfinance for the Poor by UNDP Myanmar intend to help improve the situation of poor rural people. However, the activities of international organizations, donor agencies and NGOs were strictly limited by the previous military government and the organizations themselves. Instead of development assistance, international organizations such as UNDP could provide only humanitarian assistance to Myanmar due to the violation of human rights in Myanmar.

### **3. Current Reforms for Social Protection**

There are two dimensions of social protection schemes in Myanmar: contributory schemes such as the social insurance or the social security scheme and non-contributory schemes. Based on such classification, legal frameworks and institutional arrangements are also diverse.

As the initiation for contributory schemes, the very first Social Security Act of Myanmar was enacted in 1954 and implemented in 1956. Since the act has been in effect for more than half a century, it no longer matches with the current situation, or ILO conventions, and therefore reduces the protection of the interests of employees and employers. Therefore, the Ministry of Labour has very recently amended the new Social Security Law, on 31 August 2012. The new law provides wider and more significant schemes so that it is more reliable for the grassroots level. The improvements of the newly enacted Social Security Law 2012 against the old one, the Social Security Act 1954, are shown in Table (5).

Apart from the Social Security Act, the country has already had another legal framework for workmen aiming to protect labour rights, which is the Minimum Wages Act of 1949. It was enacted to provide for the regulation of the remuneration and conditions of employment of workers in certain circumstances. However, as it could only be active with trade unions, the act was no longer enforced throughout socialist period and military regime.

With the change to the new administration, the government initiated the restoration of a law on minimum wages. Meanwhile, due to a series of labour strikes for wage rises, the Ministry of Labour has instructed that the minimum wage of workers working in various industrial zones will be set at 56,700 kyats (about US\$67 at prevailing market exchange rate) per month. The old law supported setting up a Minimum Wages Council to activate the Act whereas the new law will mandate the union government to form a National Committee for determining the minimum wage.

The new law will provide guidelines to determine the categories of work, the facts to be used as the basis in determining minimum wage, issuing notification to determine minimum wage, duties of employers and rights of workers relating to the minimum wage.

Table 5. Comparison between the Social Security Act 1954 and the Social Security Law 2012

No.	Particulars	Social Security Act 1954	Social Security Law 2012
1.	Coverage	- Sickness Benefit, Maternity Benefit and Death Grant - Temporary Disability and Permanent Disability (due to employment injury) and Survivors' Pension	- Benefits imposed in old law - Education allowance for the children of insured workers who earn less than the specified income - Cash benefit and relief commodities in times of natural disaster
2.	Maternity Benefit	- Maternity benefit given to insured women	- Leave and cash benefit as paternity benefit for the insured worker in times of confinement of his wife - Maternity grant
3.	Benefit for Incapacity of Work	- Due to employment injury	- Owing to various causes
4.	Survivors' Benefit to the surviving family members of an insured person who has died	- Due to employment injury	- Died of any cause
5.	Superannuation Pension	Nil	- For an insured person who continued working until the age of retirement
6.	Unemployment Benefit	Not available	Available
7.	Social Security Housing Scheme	Not available	Available

*Source:* Compiled by the author based on respective laws

Regarding non-contributory schemes, the social welfare policy of the Myanmar government is conceptually based on equalization of opportunities for vulnerable groups in Myanmar society. The government attaches a high priority to the welfare of children, youth, women, nationals residing in the underserved areas, rural populations, the disabled, the aged, the socially handicapped and disadvantaged groups.

Laws in Myanmar regarding non-contributory social protection schemes include the Law on Rehabilitation and Employment of Persons with Disabilities 1958, the Myanmar Maternal and Child Welfare Association Law 1990, the Myanmar Child Law 1993, and the Anti Trafficking in Persons Law 2005. The Law on Rehabilitation and Employment of Persons with Disabilities 1958 is being reviewed for further amendment to ensure broader rights of persons with disabilities. Table (6) shows the main points of the respective laws.

Table 6. Laws related to Non-Contributory Social Scheme

No.	Law	Significance and Coverage
1.	Law on Rehabilitation and Employment of Persons with Disabilities 1958	- Rights to health, education and employment - Medical Rehabilitation - Vocational Training and Right to Education - Help to be given on Humanitarian Grounds - Right to Work
2.	Myanmar Maternal and Child Welfare Association Law 1990	- To carry out effectively welfare work and assistance relating to the health and social affairs of mothers and children - To organize and disseminate basic education in maternal and child health and welfare - To render aid and assistance relating to health and social affairs to the public, when necessary
3.	Child Law 1993	- Right of child to survival, development, protection and care and to achieve active participation within the community
4.	Anti Trafficking in Persons Law 2005	- Preventing and suppressing trafficking in persons, paying particular attention to women, children and youth

*Source:* Compiled by the author based on respective laws

#### 4. Key Issues and Challenges for Proper Social Protection and Resilience

Myanmar has already established and has been operating social security and social welfare schemes. Yet, social protection has a broader meaning and it is a huge challenge for a developing country like Myanmar to realize it. Because of the inequalities stemming from class disparity and income distribution gap, the vulnerable in Myanmar are facing difficulties. Particularly, rural and border areas are lagging behind in development. Such regional disparity arises from poor transport infrastructure and economic opportunities. Significant issues and challenges for proper social resilience with inclusiveness are as follows:

##### 4.1 Poverty and Inequality

According to the Integrated Household Living Conditions Assessment (IHLCA)<sup>2</sup> 2009/10 jointly conducted by the UNDP and the Ministry of National Planning and Economic Development, overall poverty incidence has declined from 32.1 percent in 2004/05 to 25.6 percent in 2009/10. Although the country achieved some degree of poverty reduction, there are still more than a quarter of the population living in poverty.

Additionally, the incidence of poverty varies widely between urban and rural areas as well as among regions/states. The proportion of the poor in rural areas, at 29.2 percent, is higher than that in urban areas, at 15.7 percent. Also, the poverty incidence is highest in Chin State, at 73.3

<sup>2</sup> The Integrated Household Living Conditions Assessment (IHLCA) survey is a nationwide survey in which data are collected from more than 18,000 households to determine poverty levels, household living conditions and Millennium Development Goals (MDG) indicators for Myanmar. The first IHLCA survey was conducted in 2004-2005 and provided important poverty estimates for Myanmar. The second IHLCA was conducted during 2009-2010.

percent, whereas it is only 11.4 percent in Kayah State. The regional distribution of poverty incidence is shown in Table (7).

Table 7. Incidence of Poverty by Urban-Rural Area and State/Region, 2010

State/Region	Urban	Rural	Overall Poverty	% of Total Population	National Poverty Share
Kachin	23.4	30.6	28.6	2.6	2.9
Kayah	2.3	16.3	11.4	0.3	0.1
Kayin	16.8	17.5	17.4	2.8	1.9
Chin	52.1	80.0	73.3	0.7	2.1
Sagaing	16.0	14.9	15.1	10.3	6.1
Tanintharyi	16.7	37.5	32.6	2.7	3.5
Bago	19.0	18.2	18.3	10.1	7.2
-Bago (East)	20.9	20.1	20.2	5.6	4.4
-Bago (West)	15.6	15.9	15.9	4.5	2.8
Magway	15.8	28.2	27.0	8.5	8.9
Mandalay	14.1	31.6	26.6	14.4	15.0
Mon	17.8	16.0	16.3	4.3	2.7
Rakhine	22.1	49.1	43.5	7.2	12.2
Yangon	11.9	28.7	16.1	12.9	8.1
Shan	14.1	39.2	33.1	8.3	10.6
-Shan (South)	8.3	31.2	25.2	3.7	3.6
-Shan (North)	16.3	43.1	37.4	3.5	5.1
-Shan (East)	28.6	52.3	46.4	1.1	1.9
Ayeyarwady	23.1	33.9	32.2	14.8	18.6
<b>UNION</b>	<b>15.7</b>	<b>29.2</b>	<b>25.6</b>	<b>100.0</b>	<b>100.0</b>
- Urban	n.a.	n.a.	15.7	26.0	15.9
- Rural	n.a.	n.a.	29.2	74.0	84.1

Source: UNDP 2011

Such high poverty ratios and regional inequality create difficulties for the government and related NGOs to fully implement social protection, and consequently has an impact on the social resilience of the Myanmar people. In order to raise poor people from below poverty line, the resource requirements for the funding of social protection can be estimated by using poverty intensity<sup>3</sup>. According to the IHLCA 2009/10, the poverty intensity was 4.1 percent, the poverty line was at 376,151 kyats, and the population was 59.0 million in Myanmar. Using these figures, the necessary investment to alleviate poverty can be computed as below:

$$\begin{aligned}
 \text{Funding Requirements} &= \text{Poverty Intensity} \quad \times \text{Poverty Line} \quad \times \text{Total Population} \\
 &= 0.041 \quad \times 376,151 \text{ kyats} \quad \times 59.0 \text{ million} \\
 &= 909,909 \text{ million kyats}
 \end{aligned}$$

Thus, as of 2010, the poor in poverty needed about 909.9 billion kyats (or US\$854.4 million at the prevailing average market exchange rates of 1,065 kyats per US\$ in 2010) equivalent of resources to escape from poverty. The resource requirement is equivalent to 3.0 percent of GDP or 14.4 percent of government budget expenditure.

<sup>3</sup> The intensity of poverty is a measure for the extent to which the people in poverty are below the poverty line (known as the poverty gap) multiplied by the poverty headcount.

Besides the absolute population below the poverty line, the transitional poor who slip into and out of poverty is estimated as three times greater than the chronic poor, according to the IHLCA findings. This means that a larger share of the population is vulnerable in that they may fall into poverty as a result of an income shock such as loss of employment or natural disaster. In this regard, more funds will be required to overcome such poverty dynamics.

The consequences of poverty include migration and human trafficking which exacerbates the challenges for social resilience of the Myanmar people. Due to poor livelihoods and inadequate job opportunities, the young Myanmar labour force migrated to neighbouring countries to seek their income. The estimates of migrant workers number in the millions in Thailand, in the hundreds of thousands in Malaysia and Singapore, and in the tens of thousands in China. There are various cases of defenceless migrants suffering labour abuses, attacks by gangs, slavery, trafficking and sometimes forced marriages.

#### **4.2 Inadequate Social Security Coverage**

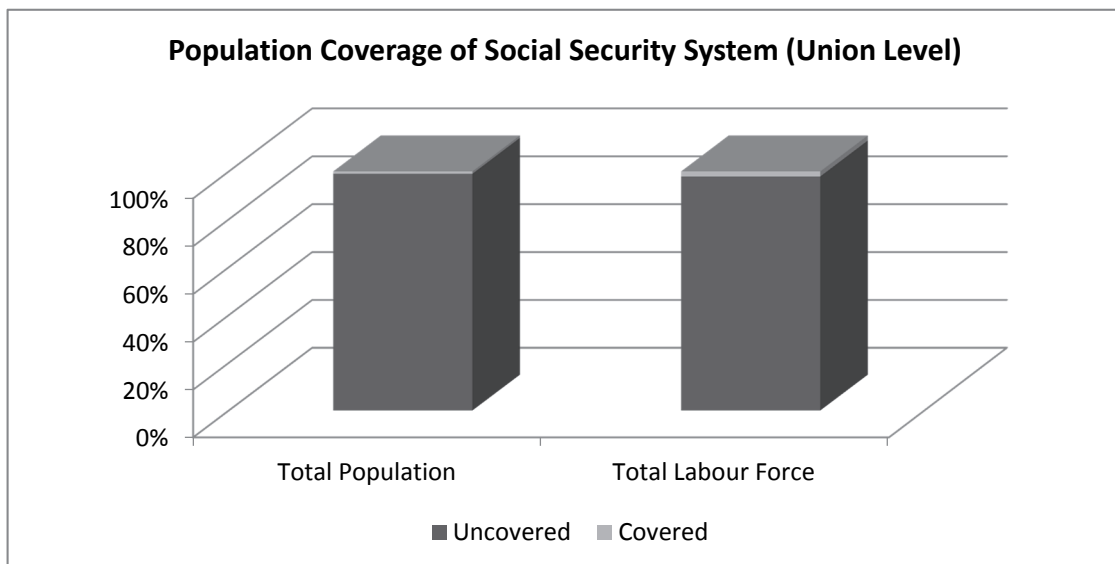
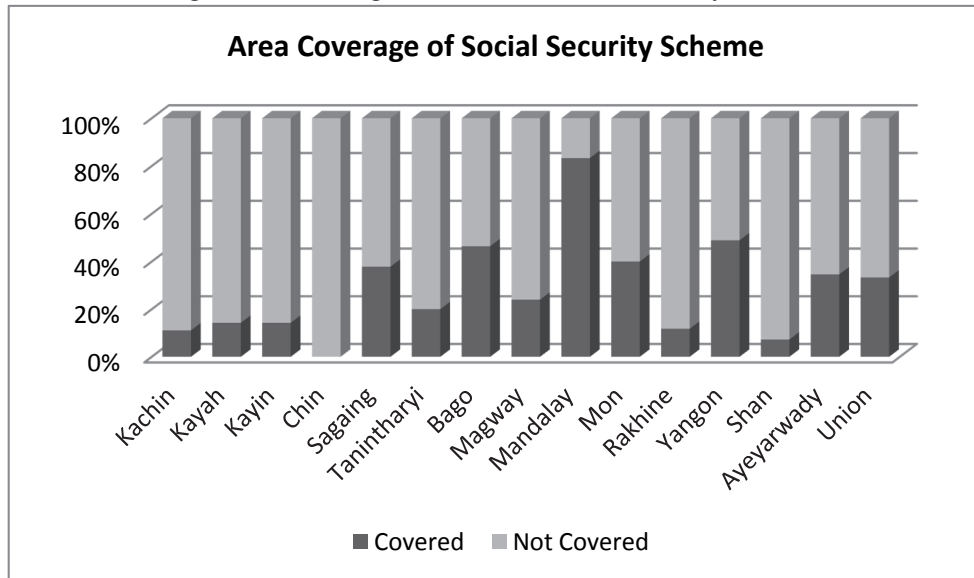
The government runs a social security scheme that covers about 570,000 formal workers in selected industrial establishments or around 2 percent of the total labour force (see Table 1). The scheme, managed by the Ministry of Labour, first came into effect in 1956 in the Yangon area and was then extended in stages to areas with a significant number of industrial workers. The areas and estimated beneficiary coverage is shown in Figure (1).

The social security scheme is financed by contributions from the employees themselves (who pay 1.5 percent of their wages) and their employers (who pay 2.5 percent of the worker's wages). All workers employed in covered establishments are compulsorily insured irrespective of the type and nature of their employment (whether they are wage earners or salaried workers, permanent or temporary) and irrespective of the level or form of their remuneration. Apprentices and trainees are also compulsorily covered. The system is administered by the Social Security Board, which registers employers and employees in covered establishments, collects contributions, pays out cash benefits, and provides free medical care to contributors.

No formal pension scheme exists in Myanmar; however, the Myanmar culture encourages people to rely on their extended families for care in their old age. However, a programme called "Homes for the Aged" has been established to provide care for those in need.



Figure 1. Coverage of Current Social Security Scheme



Source: Ministry of Labour

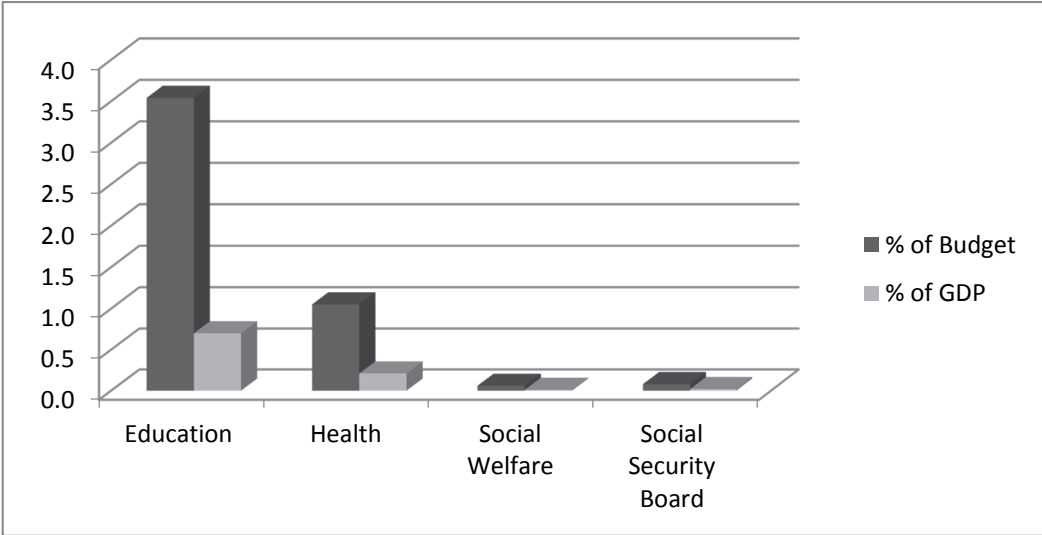
Free medical care, employment injury benefits and cash benefits are the main responsibilities of the social security scheme. For workers not covered by the social security scheme, the Workmen’s Compensation Act places the liability for compensation for work accidents on each individual employer. The Act covers personal injuries resulting from employment accidents and occupational diseases. The following provisions are made under these schemes:

- Cash payments are provided to workers insured under the social security scheme in case of sickness, maternity, death and employment injury.
- Free medical care is provided to those insured under the social security scheme through social security board clinics, departmental enterprise clinics, and workers hospitals.

**4.3 Poor Social Safety Net Scheme along with Limited Funds**

Myanmar has some social welfare programmes for particularly disadvantaged groups, but public expenditure on these programmes is limited and the number of people that they assist is very small. Total expenditure on social welfare, relief and resettlement in 2011-2012 was 5,042 million kyats (provisional actual) or roughly US\$6.04 million at prevailing exchange rate. The major components of these programmes include care and welfare services for the children, youth, women and the disabled. These programmes are mainly targeted to groups such as orphans, the disabled, or frail older people who have no family to support them. With a union-level poverty incidence of 25.6 percent or more than 15 million of the population under the poverty line, expenditure on social welfare at about 0.06 percent of total government expenditure or 0.01 percent of GDP in the 2011/2012 fiscal year as shown in Figure (2) is in fact not sufficient to achieve a decent social resilience status.

Figure 2. Social Expenditure of the State Budget (2011/2012)



Source: MNPED 2012 and Union Budget Law 2011/2012

One major cause of low levels of expenditure in the social sector might be the long-lasting civil war in Myanmar and the consequent high levels of expenditure on military affairs. The government budget allocation flows relatively more into military purposes, which reduces government funding sources to be allocated to the other sectors including social security and social welfare. According to estimates, military expenditure in the civil war between the Myanmar army and the Kachin Independence Army (KIA) during a one year period was equivalent to five times the expenditure in the social sector including education, health and social welfare<sup>4</sup>.

Apart from the government budget, a number of donors support a variety of social assistance programmes in the areas of food security, health, and education. Particularly in the aftermath of cyclone Nargis in May 2008, donors provided essential relief and early recovery

<sup>4</sup> Budget allocation for the Ministries of Education, Health and Social Welfare in 2012-2013 was about 1,169 billion kyats. Military expenditure for a total of more than 10,000 battles within one year was estimated to be 6,000 billion kyats or about 600 million kyats each.

assistance by supporting food distribution, provision of agricultural inputs and small tools and equipment, cash for work for restoration and rehabilitation of rural infrastructure facilities such as village footpaths, small dams, erection of embankments, small jetties, etc. Most of these support programmes are designed to assist the rural poor to meet their food and nutrition and other basic needs. They include, among others, conditional cash transfers to households to encourage sending their children to primary school and to support pregnant and lactating mothers to provide nutrition foods and supplements. Other items of support include outright cash grants to the most vulnerable households to undertake household level small income generating activities such as homestead gardening, agriculture, fishing, rearing livestock, and off-farm and non-farm income generating activities such as village grocery stores, small trading, snack making, etc.

#### **4.4 Inadequate Legal Framework and Enforcement**

There are specific laws to provide social protection in limited areas and for relatively small numbers of beneficiaries, such as in relation to workmen's compensation and the social security scheme for the formal sector. The legal framework to protect employed workers suffering workplace injuries exists and holds employers liable but it is, by definition, limited by excluding informal or self-employed workers and farmers. It is also limited to a private law obligation without public sector involvement in ensuring adequate protection is provided by the system. Injuries and loss of income-earning ability incurred outside of the formal employment context are not covered.

Outside the scope of the social security system, which currently covers government workers and formal-sector employees, and other institutional systems such as the armed forces, there is no mechanism to ensure income transfers to the elderly people.

Very recently, the Social Security Law was enacted on 31 August 2012 which replaced the 1954 Social Security Act. In order to implement the law, Social Security Rules are to be developed with the inclusion of pension schemes for all elderly people and other insurance schemes. The new law covers pension schemes for not only government servants but also employees from the private sector. Moreover, it includes unemployment insurance and other social insurance such as housing schemes. Yet, it will take additional time to start to enforce the law due to infrastructure and institutional constraints. Also accessibility and affordability for the majority of the people are not certain in the current economic situation. Employees and employers have to contribute 1.5 percent of their salary for free medical care as opposed to 3 percent each for survivors' benefit.

#### **4.5 Less Awareness on Corporate Social Responsibility (CSR)**

Corporate Social Responsibility (CSR) is an important issue contributing toward inclusive growth, but the responsibility lies mostly with the private sector. The businesses in Myanmar so far invested in by local sources and by those abroad still need to take care of their obligations to the

community in terms of economic, social and environmental points of view. With a narrow knowledge of CSR, as the result of a half century long isolation and a dictatorial administration, the businesses in Myanmar have been lacking awareness of their responsibilities which include appropriate actions to improve the living conditions of not only staff and employees but also local communities as a whole. Moreover, CSR also requires reducing the negative impacts of the businesses.

The pattern of links to be able to do business in Myanmar in the recent past was simply to have a good connection with authorities, and did not necessarily need to pay attention to the people. Unfavourable investment practices such as forced relocation, land confiscation, labour exploitation and failure to provide a safe and healthy working environment were frequently occurring in the Myanmar economy. There are still a number of consequences of these irresponsible investments to be tackled by the new government. Although there is encouragement and inducements by the government and NGOs to adopt CSR mechanisms in private businesses, a series of protests and demonstrations against reckless investments and businesses in recent times call for more consistent and realization in practice. Also, the new Social Security Law encourages employers and employees to contribute to a security fund for the benefit of employees but only a limited number of business owners conform.

## **5. Recommended Strategies for Inclusive Growth Through Stronger Social Protection**

### **5.1 Provide Equal Opportunities for All**

Basic education, primary healthcare and food security are minimum basic requirements of the people to be supported by the government. Myanmar has already prescribed that every citizen has the right to education and shall be given compulsory basic education. Additionally, monastic schools which are opened in certain monasteries and provide free basic education are also important players to fulfil education for all. Health policy has also placed the goal of health for all as a prime objective using a primary healthcare approach. More specifically, the government's initiative of a contributory social insurance system guarantees medical care and health benefits for insured formal workers.

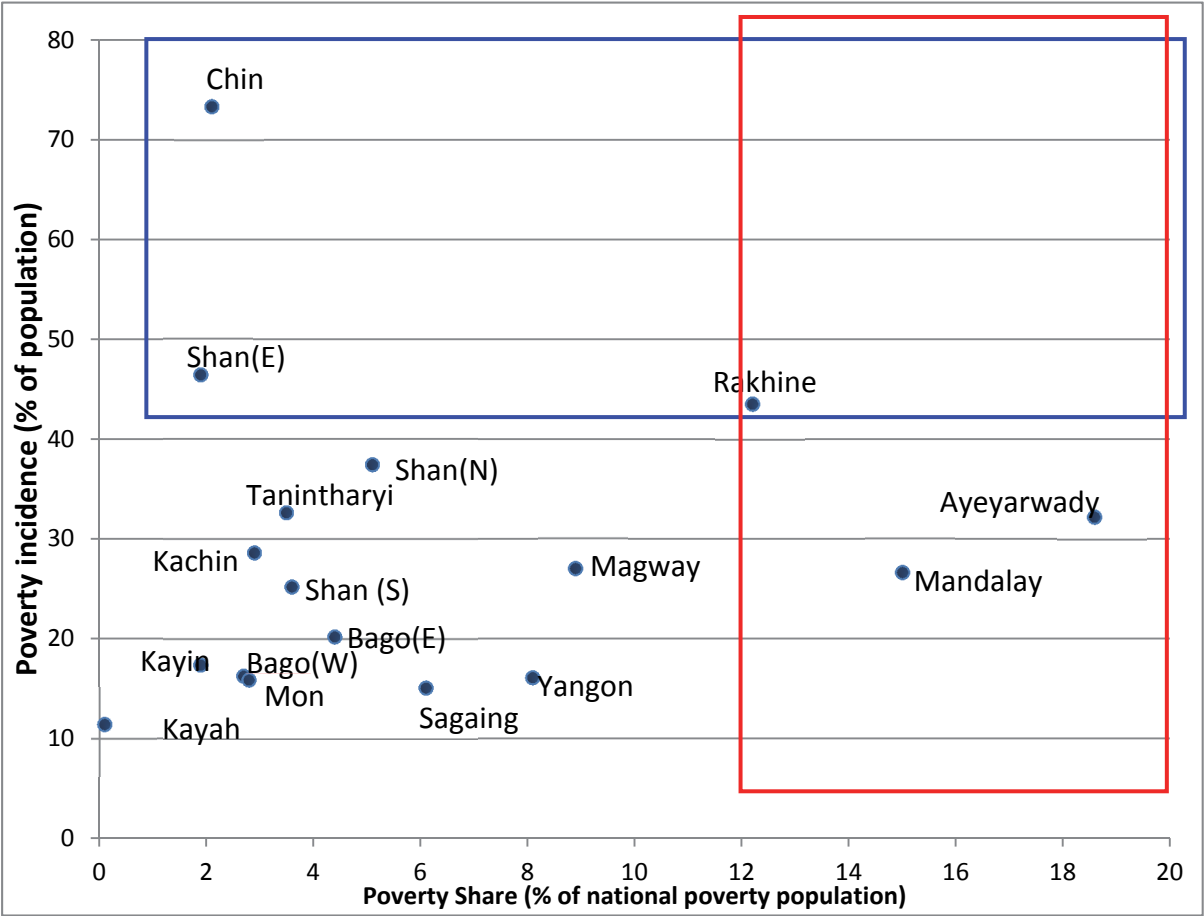
However, there are many children unable to access basic education and many patients incapable of obtaining free medical treatment. Informal labourers and even formal but uninsured workers are outside of the government's social security scheme. Disparity among regions/states and between urban and rural areas should be reduced so as to provide equal opportunities as much as possible. In order to narrow down the disparities, fundamental infrastructures such as roads & means of transportation, communication, school buildings & accessories, and hospital/health centres & facilities should be adequately provided. Required financial resources for these infrastructures are not small but there is room to increase the budget allocation from the current share of less than 10 percent to the health and education sectors. This is the appropriate time to raise funds for the better livelihoods of the people since bilateral and multilateral development

partners are lending their hands for Myanmar’s development process. Also, private sector participation in the state’s development activities through public-private partnership is readily applicable in these days.

**5.2 Focus on Balanced and Proportionate Growth**

In order to create equal opportunities across the country, balanced and proportionate growth should be considered. One of the four economic policy objectives set by the government is to achieve balanced and proportionate growth among regions and states. However, the strategy for such growth is not yet clearly identified. Firstly, the selection of priority areas should be accomplished. According to the latest poverty survey in the form of the Integrated Household Living Condition Assessment (IHLCA) 2011, Chin State is the poorest with a poverty incidence ratio of 73.3 percent but its share of national poverty is just 2.1 percent. In contrast, the Ayeyarwady Region has an overall poverty incidence rate of 32.2 percent but has the greatest poor population at about 19 percent share of national poverty. Based on that statistical data, it is necessary to define the most vulnerable area in order to allocate scarce resources in an effective way. The following figure suggests the priority areas to be emphasized for balanced growth.

Figure 3. Priority Areas (Regions/States) for Consideration for Balanced Growth



Source: Data from UNDP & MNPED 2011

Out of 17 administrative areas, Chin State, Shan State (East) and Rakhine State are the most impoverished with poverty incidence of 73.3, 46.4 and 43.5 percent respectively. On the other hand, the Ayeyarwady Region, Mandalay Region and Rakhine State have high shares in national poverty with 18.6, 15.0 and 12.2 percent respectively. Among these, Rakhine State is the most vulnerable in terms of having both a high poverty incidence as well as a high poverty share, so that the state should be considered as the first priority for growth and inclusiveness. The next priorities should then be the Ayeyarwady Region, Mandalay Region, Chin State and Shan State (east).

### **5.3 Provide Income Opportunities and Efficiency Gains**

Low income opportunities and low efficiency of human resources are major causes of fragile social resilience with a high poverty rate and inadequate social protection, particularly in terms of social safety net schemes. The people in areas affected by Cyclone Nargis are the most significant example. This was the most severe natural disaster in Myanmar's history, which devastated the lives of more than 130,000 people and severely affected some 2.4 million people (TCG 2008). Smallholder farmers, communities dependent on small-scale inshore and offshore fishing, landless poor dependent on wage-labour in agriculture, and skilled workers previously employed in a wide-range of resource-based small and medium scale manufacturing and processing lost income earning opportunities for a substantial period. The national, regional and international responses including rescue and restructuring programmes brought the best of them. However, according to a survey in early 2013, cyclone-affected communities are still struggling to reach their previous status before Nargis. There are severe shortages of job opportunities. Fish resources have gone due to the destroyed mangroves. Agricultural lands have been invaded by salt water from the sea. Rural businesses such as rice mills, cold storage and warehouses were hard to re-establish due to a lack of sufficient investment. Many young men, therefore, migrated to urban cities and abroad to find proper jobs and income. However, their remittances are not enough for their families to break out from the poverty trap, so the high rate of poverty persists.

The high rate of poverty actually puts a burden on the country in accomplishing effective coverage of social protection programmes. Therefore, it is essential to create job opportunities and labour productivity in order to earn sufficient income. To do so, investments from domestic sources and foreign economies are necessary drivers but these investments should lead to productive sectors with job creation, rather than resource extraction sectors such as mining and oil & gas exploration and export. Moreover, voluntary social contribution by investors in the form of corporate social responsibility should be stimulated with proper policy formulation and inducements.

#### **5.4 Extend Effective Coverage of Social Protection System**

Although equal opportunities are provided to entire people, not everyone is able to participate in the growth process. Some people will pursue but lag behind the growth due to skewed income distribution while some will be left far behind or drop out from growth process. The existence of these groups of people calls for social security and a social safety net. A large proportion of the population remains desperately poor so that it is difficult for them without a social safety net which could help them to survive the economic shocks of man-made and natural disasters. The necessity for social assistance mechanisms became clear in the aftermath of Cyclone Nargis in 2008, which left the affected people without systemic socioeconomic support.

Myanmar's social protection system needs to be extended beyond the formal social security system to include comprehensive social assistance. The pension scheme which covers only the government staff at present should gradually be extended to cover a larger segment of the population including informal workers and their families. At the same time, while making vigorous attempts to create job opportunities, unemployment compensation, which is currently totally lacking in the country, should be initiated as a social safety net scheme. Also, a social transfer programme such as conditional cash transfers and child grants should be introduced at either the union or state/region level.

Regarding institutional frameworks, it is recommended to organize an institution for concrete social protection mechanisms to avoid developing a fragmented system with various providers. For example, China, Indonesia and Thailand have established social protection agencies under the president's or prime minister's office, reflecting the high policy priority of the issue. Since social protection is closely associated with other public guidelines such as fiscal policy, labour market policy, investment policy and financial policy, the stability and supportiveness of these policies are important to accomplish secure social protection. Additionally, it should be possible to link social protection policies to the poverty reduction strategy of the society as a whole.

#### **5.5 Seek Financing for Social Protection**

Social protection covers a wide range of policies and programmes against economic and social risks including unemployment, vulnerability, disability and ageing. Therefore, the funds required to cover all of these situations are too large to be borne by the government alone. Myanmar as a less developed economy needs social security assistance programmes to reduce poverty, and more vulnerable people such as children and women should be provided with health and education. Apart from policies designed to promote employment and income opportunities, financial intervention for social insurance and social assistance is a challenge for Myanmar.

Therefore, it is time for the government to launch social welfare provision or social assistance as non-contributory plans in cooperation with non-governmental organizations (NGOs) and civil society organizations (CSOs). As a result of the first Myanmar Development

Cooperation Forum held in January 2013, donors of foreign economies agreed to align assistance projects with the government policies covering education, health and poverty reduction. Hence, foreign aid flows and government budget contributions to the social sector, which still has a lot of room for expansion from the current level of less than 3 percent of GDP, would be major sources of funding for non-contributory social protection.

As for the contributory social security scheme, Myanmar needs to establish a proper funding system. The country has already set up a pension scheme limited to permanent government staff and a social security scheme only available to formal labourers on a voluntary basis for medical benefit. Employees in the private sector are not provided with a retirement pension and also self-employed persons are not entitled to medical benefits. These self-employed persons should be included in the social security scheme by regulating their contributions to be equivalent to the sum of contributions of employers and employees of defined groups. There is a clause relating to unemployment benefit in the new Social Security Law 2012 but it needs to be activated by enacting respective rules including the means of financing.

## **6. Conclusion**

Myanmar, on its path of transitioning to a democratic country, has many lessons to learn from forerunner economies. The Asian region has already experienced high growth performance and a consequent rapid reduction in its poverty levels. Simultaneously, these countries with high growth start paying more attention to improving the lives of the people by promoting social protection and social security. The Indonesian government, for example, committed to health insurance for every citizen by 2014, which would become the largest national health network in the world. China could extend its pension scheme to cover 240 million rural people within two years. In India, 40 million households benefit from the government's plan to have jobs for at least 100 days a year with a guaranteed minimum wage. On the other hand, the troubles that resulted from overpromises for the provision of social services such as healthcare and old-age pensions can be seen in the case of developed countries in Europe and America. Therefore, social protection in Myanmar must be responsive to the wants and needs of the people within the resources available. It is crucial for the government to design and implement balanced and realistic policies. It is also good to learn from the experience of Singapore, in which government expenditure is around one fifth of GDP but its education, healthcare and social security are at the top level in the world. Nevertheless, Myanmar is in a position to enjoy latecomer's advantages and to structure with the best model of social protection for its people on the way to inclusive growth.



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# Social Protection in Cambodia

Vannarith Chheang<sup>1</sup>

## 1. Introduction

Social protection and safety net are essential tools in poverty reduction, promoting an inclusive growth, and narrowing development in the developing world. It is considered that access to adequate social protection “instrumental in promoting human welfare and social consensus on a broad scale, and to be conducive to and indispensable for fair growth, social stability and economic performance, contributing to competitiveness.”<sup>2</sup>

Southeast Asian economies with the absence of a common understanding and approach to social protection are confronted with a lack of regional mechanisms to effectively respond to social protection issues. Social protection started gaining momentum of policy attention in the aftermath of the Asian financial crisis in 1997 and the global financial and economic crisis in 2008.

Cambodia was hit pretty hard by the global economic crisis in 2008-2009. There were about 50,000 jobs lost in the textile and clothing industry and more than 60,000 jobs lost in the construction sector. Social protection policy was formulated and institutionalized to support the poor and vulnerable.

Cambodia started developing institutional provisions for social protection in the late 2000s. The National Social Protection Strategy for the Poor and Vulnerable (NSPS) adopted in 2011 provides policy guidelines and action plans to strengthen the social protection system in the country. In addition, Cambodia also tries to put into practice the recommendations concerning national floors protection prepared by the International Labor Organization (ILO) in 2012.<sup>3</sup>

The report aims to provide the current status of and factors shaping vulnerability among groups and across the life course in Cambodia. It then discusses social protection policy issues, constraints, and challenges.

## 2. Background and Context

Cambodia is geographically located in mainland Southeast Asia. It shares borders with Vietnam, Lao PDR, and Thailand. It has tropical weather with two distinctive seasons: rainy

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<sup>1</sup> Senior Fellow, Cambodian Institute for Cooperation and Peace

<sup>2</sup> International Labor Organization (ILO), <http://ilo.org/global/about-the-ilo/decent-work-agenda/social-protection/lang--en/index.htm>

<sup>3</sup> Members should, in accordance with national circumstances, establish as quickly as possible and maintain their social protection floors comprising basic social security guarantees. The guarantees should ensure at a minimum that, over the life cycle, all in need have access to essential health care and to basic income security which together secure effective access to goods and services defined as necessary at the national level.

season from June to October, dry and cool season from November to February, and dry and hot season from March to May.

As of 2013, Cambodia's population was 15.14 million. The majority of the population (about 80%) resides in rural areas, practicing traditional wet rice cultivation and other forms of agriculture. The Khmer make up 90% of the population and mostly live in the lowlands. Other ethnic groups include Vietnamese, Chinese, Cham-Malay and other ethnic minorities.

Cambodia was under the French colonial rule for almost a century (1886 to 1953) and went through a civil war for three decades. After restoring peace and order, and introducing a free market economy in the early 1990s, Cambodia embarked on a new development path with a remarkable annual growth rate of about 6% in the last three decades.

International development assistance, trade openness, and a gradual inflow of foreign direct investment play critical roles in socio-economic development and poverty reduction. The poverty rate was reduced from 53% in 2004 to 20.5% in 2011. This means that two out of ten Cambodians are poor in 2011, compared with five out of ten in 2004.

In 2012, the human development index (HDI) value for Cambodia was 0.543, ranked at 138 out of 187 countries and territories. It shared the same rank with Lao PDR. Between 1995 and 2012, Cambodia's HDI value increased from 0.411 to 0.543, an increase of 32% or an average annual increase of 1.7%.<sup>4</sup>

In terms of implementing the Millennium Development Goals (MDGs), Cambodia has achieved slightly more than 50% of the targeted Cambodia Millennium Development Goals (CMDGs) (according to the study conducted in 2011). It achieved 48% for CMDG1 (to eradicate extreme hunger and poverty), 56% for CMDG2 (to achieve universal primary education), 58% for CMDG3 (to promote gender equality and empower women), 63% for CMDG4 (to reduce child mortality), 59% for CMDG5 (improve maternal health), 57% for CMDG6 (to combat HIV/AIDS, malaria and other diseases), 38% for CMDG7 (to ensure environmental sustainability), and 59% for CMDG8 (to develop a global partnership for development).<sup>5</sup>

## **Demographic factors**

Cambodia has a great demographic dividend since it is one of the youngest countries in the region in terms of population. In 2012, the population was 14.8 million, in which 5.5 million are aged from 6 to 18, and 1.6 million are aged below 5 years.

The annual average population growth rate from 1990 to 2012 was 2.3%. The urban population growth rate is 2.1% while the rural population growth rate is 1%. The population aged 0-14 years has the highest growth rate at 30.7% in 2012. The sex ratio (males per 100 females) is

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<sup>4</sup> UNDP, Human Development Report 2013, Cambodia. <http://hdr.undp.org/sites/default/files/Country-Profiles/KHM.pdf>

<sup>5</sup> UNDP Cambodia, Millennium Development Goals Score Cards. Available at [http://www.kh.undp.org/content/dam/cambodia/docs/PovRed/UNDP\\_KH\\_Cambodian%20MDG%20Scorecard%202012.pdf](http://www.kh.undp.org/content/dam/cambodia/docs/PovRed/UNDP_KH_Cambodian%20MDG%20Scorecard%202012.pdf) (accessed on August 15, 2014).

96. The estimated population growth rate from 2012 to 2030 is 1.4% lower than the previous two decades.

According to the survey conducted by the Directorate General for Health and the National Institute of Statistics, household members consist of an average of 4.7 people, 35% being children under the age of 15. Only 19% of rural households get access to electricity. In the rainy season, almost 80% of households have access to an improved water source but in the dry season only 59% of households have access. Only one-third of all households have improved toilet facilities and 57% of households have no toilet facilities.<sup>6</sup>

Table 1. Demographic indicators

Population (thousands) 2012, total	14,864.6
Population (thousands) 2012, under 18	5,557
Population (thousands) 2012, under 5	1,669.2
Population annual growth rate (%), 1990-2012	2.3
Population annual growth rate (%), 2012-2030	1.4
Crude death rate, 1990	12.4
Crude death rate, 2012	6
Crude birth rate, 1970	43.1
Crude birth rate, 1990	42.3
Crude birth rate, 2012	25.9
Life expectancy, 1990	54.9
Life expectancy, 2012	71.6
Total fertility rate, 2012	2.9
Urbanized population (%), 2012	20.1
Average annual growth rate of urban population (%), 1990-2012	3.4
Average annual growth rate of urban population (%), 2012-2030	2.8

(Source: United Nations Data, <http://data.un.org/CountryProfile.aspx?crName=Cambodia>)

### Education and human capital

Education quality is low by regional standards. The government expenditure on education is quite low. It accounts for only 2.6% of the GDP (data from 2006 to 2012). The majority of Cambodians receive primary education. The primary-secondary gross enrolment ratio accounts for about 83%. Only 37.7% of those enrolled in third-level education are female students. The literacy rate of male youths (aged 15-24) was 88.4% while the literacy rate of female youths was 85.9% (data from 2008 to 2012).

<sup>6</sup> Directorate General for Health (DGH) of the Ministry of Health and the National Institute of Statistics of the Ministry of Planning (2010) Cambodia 2010 Demographic and Health Survey Key Findings, available at <http://dhsprogram.com/pubs/pdf/SR185/SR185.pdf>

Table 2. Education indicators

Youth (15-24 years) literacy rate (%) 2008-2012, male	88.4%
Youth (15-24 years) literacy rate (%) 2008-2012, female	85.9%
Primary school participation, Net attendance ratio (%) 2008-2012, male	85.2%
Primary school participation, Net attendance ratio (%) 2008-2012, female	83.4%
Secondary school participation, Net enrolment ratio (%) 2008-2012, male	39.45
Secondary school participation, Net enrolment ratio (%) 2008-2012, female	35.8%

Access to education is geographically varied. In the Northeastern provinces (Mondol Kiri and Rattanak Kiri), 46% of women and 22% of men have no formal education. It was estimated that 74% of women and 83% of men are literate (complete primary education).

### Poverty

The poverty rate of Cambodia is one of the highest in the region although it has enjoyed a relatively high economic growth rate of about 6% from 1990 to 2013. The population below the national poverty line (US\$1.25 per day) was 22.1% in 2010 and 20.5% in 2011 compared with the poverty rate in 1993, which was about 50%.

Rural poverty is much more severe than urban poverty. In 2011, the rural poverty rate was 23.6% while the urban poverty rate was only 8.7%. It shows the widening development gap and unsustainable development path in the country. Weak state institutions together with political, economic, historical, and social factors prevented Cambodia from achieving inclusive growth and faster poverty reduction.<sup>7</sup>

Table 3. Poverty rate

Survey year	Rural %	Urban %	National %
2010	25.3	8.5	22.1
2011	23.6	8.7	20.5

(Source: World Bank, World Development Indicators)

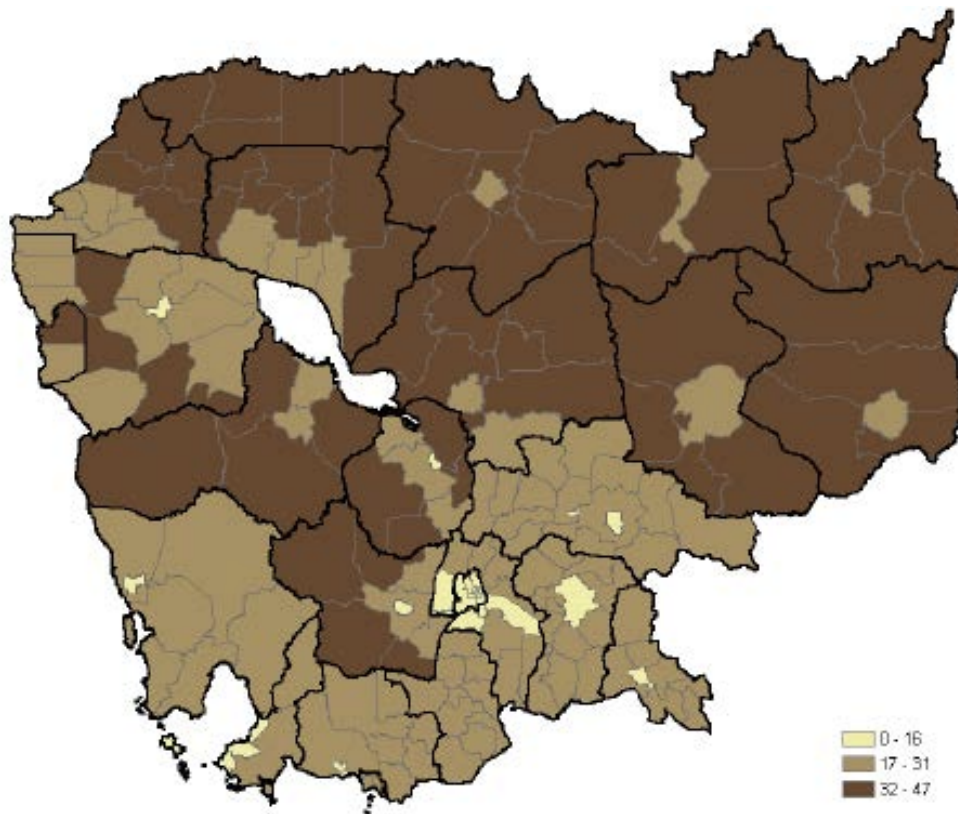
Table 4: Poverty and inequality trends

	% Population	Poverty Headcount (%)			Gini Coefficient	
		1993/1994	2004	2007	2004	2007
Phnom Penh	9.9	11.4	4.6	0.83	0.37	0.34
Other urban	10.2	--	24.7	21.8	0.44	0.47
Rural	79.8	--	39.2	34.7	0.34	0.36
Cambodia	100	47	34.7	30.1	0.40	0.43

(Source: World Bank 2006, Cambodia Poverty Assessment)

<sup>7</sup> CDRI (2012) Understanding poverty dynamics: Evidence from nine villages in Cambodia. CDRI Working Paper Series No. 69. p.1. Available at <http://www.cdri.org.kh/webdata/download/wp/wp69e.pdf> (accessed on August 15, 2014).

Figure 1. Poverty map



(Source: NSPS 2009-2013)

### Healthcare<sup>8</sup>

The health system in Cambodia has undergone several periods of structural changes. After gaining independence in 1953, the number of health services and facilities rose three-fold. But it was almost completely destroyed during the wartime. In the 1980s, it was in a period of reconstruction and rehabilitation following the Khmer Rouge regime. In 1993, the government started to improve health service infrastructure together with the creation of the Ministry of Health (MOH). Private sector and international NGOs have also contributed to strengthening health services.

However, public spending on health is still very low. It accounted for 1.3% of GDP (based on the data from 2007 to 2011). Corruption within the public health service is a chronic institutional problem. The professional ethics and capacity of health service providers are low.

Cambodia has the highest share of out-of-pocket payments compared with other economies in the region. Most out-of-pocket payments (68%) go to private medical services, including payments to unregulated private practitioners, unofficial payments in the public sector and to various participation costs, such as transportation costs. Only 18.5% is spent in the public sector.

<sup>8</sup> Data from the survey conducted by Directorate General for Health (DGH) of the Ministry of Health and the National Institute of Statistics of the Ministry of Planning (2010) Cambodia 2010 Demographic and Health Survey Key Findings, available at <http://dhsprogram.com/pubs/pdf/SR185/SR185.pdf>

Coping strategies to pay these health costs include using savings (51%), using wages/earnings (45%), borrowing money (18%), and selling assets (8%), all of which force the poor and the near poor to fall into the poverty trap.<sup>9</sup>

The infant mortality rate is 45 deaths per 1,000 in 2010. Under-five mortality rates have decreased from 83 deaths per 1,000 live births in 2005 to 54 deaths per 1,000 in 2010. Such decrease is attributed to mother's education and financial resources. With regard to the maternal mortality ratio, it was 206 per 100,000 live births in 2010. It was reduced by more than half from the maternal mortality ratio reported in 2005 (which was 472 per 100,000).

Regarding vaccination coverage, 79% of Cambodian children aged 12–23 months have received all recommended vaccines—one dose each of BCG and measles, and three doses each of tetraivalent or pentavalent and polio. Only 4% of children did not receive any of the recommended vaccines.

Relating to children's nutrition status, 40% of children under five are stunted or too short for their age. This indicates chronic malnutrition. Stunting is more common in rural areas (42%) than urban areas (28%). Stunting is least common among children of more educated mothers and those from wealthier families.

A number of financing mechanisms have been created to promote access to effective and affordable health care for the population, especially the poor and vulnerable. These include:

- Direct tax-funded health services plus user fees for the non-poor and exemptions for the poor, including monks, disabled war veterans, the elderly, and eligible poor people;
- Performance-based contracting for services, either to public or private providers, for delivering services to specific groups – used in 22 operational districts;
- Voluntary Community-Based Health Insurance targeting the informal sector at the community level – used in 18 operational districts;
- Health Equity Funds to reimburse health providers for services delivered to eligible poor and to meet patient food, transport and other costs related to access – used in 58 operational districts with a demonstrated increased service utilization and reduced health-related debt for patients. User fees for services in these schemes have also been standardized.
- Voucher schemes which allow vouchers to be used instead of paying a user fee at selected providers for specific health services – used in 9 operational districts.

## **Unemployment**

The unemployment rate in Cambodia averaged 1.31% from 1994 until 2012. In 2012, the unemployment rate was 2.7%, equivalent to 202,300 persons. The number of people entering the labor market every year is 300,000-400,000.

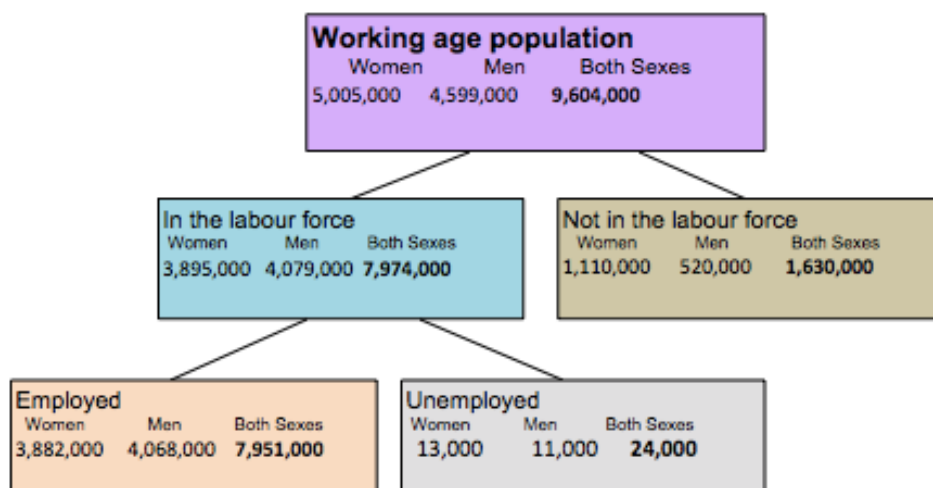
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<sup>9</sup> WHO and Ministry of Health of Cambodia, Health Service Delivery Profile, Cambodia 2012.  
[http://www.wpro.who.int/health\\_services/service\\_delivery\\_profile\\_cambodia.pdf](http://www.wpro.who.int/health_services/service_delivery_profile_cambodia.pdf)



The Cambodia Labor Force Survey 2012 indicated that skilled agriculture workers accounted for the largest share of the total employed population at 23.5% and about 22% were employed in services and sales occupations, followed by 17% in elementary occupations, 12% in machine operations and 12% in craft or related trades.<sup>10</sup>

Figure 2. Labor force and unemployment



(Source: NIS 2013)

### Women and children

Women and children are the most vulnerable group. The female adult literacy rate is lower than males. Contraceptive prevalence rate was only around 50% (according to the data in 2012). Female migrant workers (both domestic migration and international migration) are more vulnerable to human trafficking and sexual abuses.

Table 5. Women protection

Life expectancy: females as a percent of males 2012	107.8
Adult literacy rate: females as a percent of males 2008-2012	79.7
Enrolment ratios: females as a percent of males 2008-2012, Primary GER	94.7
Enrolment ratios: females as a percent of males 2008-2012, Secondary GER	84.7
Survival rate to the last grade of primary: females as a percent of males 2008-2012	102.1
Contraceptive prevalence (%) 2008-2012	50.5
Antenatal care (%) 2008-2012, At least one visit	89.1
Antenatal care (%) 2008-2012, At least four visits	59.4
Delivery care (%) 2008-2012, Skilled attendant at birth	71
Maternal mortality ratio, 2008-2012, Reported	210

(Source: United Nations Data, <http://data.un.org/CountryProfile.aspx?crName=Cambodia>)

<sup>10</sup> Cambodia Labour Force Survey 2012, [http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-bangkok/documents/publication/wcms\\_230721.pdf](http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-bangkok/documents/publication/wcms_230721.pdf)

Table 6. Child protection

Child labor (%) 2002-2012, total	36.1
Child labor (%) 2002-2012, male	36.4
Child labor (%) 2002-2012, female	35.9
Child marriage (%) 2002-2012, married by 15	2.1
Child marriage (%) 2002-2012, married by 18	18.4
Birth registration (%) 2005-2012, total	62.1

(Source: United Nations Data, <http://data.un.org/CountryProfile.aspx?crName=Cambodia>)

### People with disabilities

People with disabilities are the most marginalized group in Cambodia. According to the socio-economic survey by the National Institute of Statistics in 2003, there were 170,000 (1.5% of the total population) disabled people. The four main types of impairments are landmine injuries, polio, deafness, and blindness. Road accidents are also the main cause of human casualty and disability.

Disability and poverty are inextricably intertwined. The poor are usually the victims of landmines and UXO (unexploded ordinances). Their lack of access to basic healthcare makes them more vulnerable to infections, illness, and injuries that lead to permanent disability.<sup>11</sup>

People with disabilities experience significant exclusion from socio-economic development. They suffer from varying degrees of social, economic, and political exclusion.

According to the labor survey in 2012, the labor force participation rate of persons with a disability was 44.2%, in comparison with 71.6% for persons without a disability and far lower than the national average of 68.8%.

### Natural disasters

Cambodia is prone to a number of natural disasters including floods, droughts, storms, lightning, fires, riverbank collapses, and pest outbreak. Almost every year, these disasters cause human casualties and severely affect the livelihood of people living in the affected regions. In the 1996, 2011 and 2013 floods alone, the country suffered huge losses and damage. Each flood killed more than 200 people. From 1996 to 2013, lightning killed 751 people.

Natural disasters caused 2,050 human casualties between 1996 and 2013. Flood is the most disastrous, accounting for 53% of the total number of human casualty. Lightning is the second most common killer, accounting for 36% of the total number of human lives lost. September and October are the months when floods are most likely to occur. Both floods and lightning account for 89% of total human life loss from disasters. Besides human casualties, disasters also damage and destroy houses and rural infrastructure.

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<sup>11</sup> Phillip Thomas (2005) poverty reduction and development in Cambodia: Enabling disabled people to play a role. Disability Knowledge and Research. Available at [http://r4d.dfid.gov.uk/PDF/Outputs/Disability/PolicyProject\\_cambodia.pdf](http://r4d.dfid.gov.uk/PDF/Outputs/Disability/PolicyProject_cambodia.pdf)

## **Major sources of vulnerability**

Pregnant women, children, and the elderly are the most vulnerable groups. The maternal mortality rate remains high although it has been reduced remarkably over the years. Worldwide, there are 430 maternal deaths per 100,000 live births. In Cambodia there are 437 deaths per 100,000 live births, making maternity-related complications one of the leading causes of death for Cambodian women ages 15 to 49.

Child mortality levels in Cambodia remain high by regional standards. Every day, an estimated 50 children under five years old die mostly from preventable and treatable diseases such as diarrhea and pneumonia. While the number of children suffering from chronic malnutrition decreased slightly, the number of children suffering from acute malnutrition has increased. Major drivers of poor nutrition in young children are inadequate complementary feeding practices, poor hygiene and high prevalence of diseases, including diarrhea.<sup>12</sup>

The risks and vulnerabilities are varied among different age groups. For the youngest group (0-4 years old), the main vulnerability is proneness to stunting if the child does not receive sufficient food and nutrition during the first 1,000 days of her/his life.

For the primary school age group (5-14 years old), school dropout and child labor are the main issues. Poverty and hunger are the key factors that force this age group to drop out from school and work for a living. Normally they help their parents to work in the rice fields or construction sites or become domestic workers in the urban areas.

Lack of skills, low production, unemployment, and underemployment are the main sources of vulnerabilities for the youth and adults groups. Labor-intensive industries such as garment and construction are the two main sources of employment for this working age group. Poor working conditions, decent wages, and the lay-offs are the core issues facing factory workers.

For the elderly and disabled group, low income and uncertainty after retirement are the main concerns. Only public servants are included in the public pension scheme but the amount of pension is insufficient. There are some support programs provided to the disabled, but with limited coverage.

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<sup>12</sup> UNICEF Cambodia, <http://www.unicef.org/cambodia/6.Maternal.pdf>

Table 7. Age group and sources of vulnerability<sup>13</sup>

<i>Age group</i>	<i>Main vulnerabilities</i>	<i>Progress to date</i>	<i>Gaps and challenges</i>
Early childhood (0-4 years old)	<ul style="list-style-type: none"> <li>• Stunting;</li> <li>• Diseases (diarrhea and pneumonia, dengue fever).</li> </ul>	<ul style="list-style-type: none"> <li>• Some material and child nutrition programs are in place;</li> <li>• Breastfeeding awareness and practices.</li> </ul>	<ul style="list-style-type: none"> <li>• Service delivery is limited and of poor quality;</li> <li>• Coverage is not universal</li> </ul>
Primary school age (5-14 years old)	<ul style="list-style-type: none"> <li>• High dropout rates;</li> <li>• Poor quality of education;</li> <li>• Child labor.</li> </ul>	<ul style="list-style-type: none"> <li>• Scholarships and school feeding programs help improve school attendance;</li> <li>• Some programs in place to improve quality of education.</li> </ul>	<ul style="list-style-type: none"> <li>• Small coverage;</li> <li>• Weak education system;</li> <li>• Teacher's quality and low salary rate.</li> </ul>
Youth (15-24 years old)	<ul style="list-style-type: none"> <li>• Low productivity;</li> <li>• Low skills;</li> <li>• Unemployment and underemployment.</li> </ul>	<ul style="list-style-type: none"> <li>• Education reforms;</li> <li>• Further develop and invest in vocational training programs;</li> <li>• University-industrial partnership and apprenticeship.</li> </ul>	<ul style="list-style-type: none"> <li>• Structural challenges (corruption in the education system);</li> <li>• Lack of research and development.</li> </ul>
Adults (25-64 years old)	<ul style="list-style-type: none"> <li>• Low labor productivity;</li> <li>• Low human capital and skills;</li> <li>• Underemployment.</li> </ul>	<ul style="list-style-type: none"> <li>• Public works programs provide certain assistance;</li> <li>• Skill development programs.</li> </ul>	<ul style="list-style-type: none"> <li>• Volatile funding and assistance;</li> <li>• Lack of investment in skill development.</li> </ul>
Elderly and disabled	<ul style="list-style-type: none"> <li>• Low income;</li> <li>• Underemployment;</li> <li>• Uncertainty.</li> </ul>	<ul style="list-style-type: none"> <li>• Pensions for civil servants;</li> <li>• Private insurance coverage;</li> <li>• Some donor assistance to the disabled.</li> </ul>	<ul style="list-style-type: none"> <li>• No pensions for the poor;</li> <li>• Very limited assistance provided to the disabled.</li> </ul>
All groups	<ul style="list-style-type: none"> <li>• Health shocks.</li> </ul>	<ul style="list-style-type: none"> <li>• Health equity funds are available to finance the poor.</li> </ul>	<ul style="list-style-type: none"> <li>• Quality of health care is poor;</li> <li>• Coverage and access is not universal.</li> </ul>
	<ul style="list-style-type: none"> <li>• Crises and natural disasters.</li> </ul>	<ul style="list-style-type: none"> <li>• Public works have shown some progress in addressing the immediate impacts of natural disasters.</li> </ul>	<ul style="list-style-type: none"> <li>• Limited capacity and resources;</li> <li>• Coverage is not universal and depends on funding.</li> </ul>

<sup>13</sup> Based on the study by Sann, V. (2010), 'Social Protection in Cambodia: Toward Effective and Affordable Social Protection for the Poor and Vulnerable', in Asher, M. G., S. Oum and F. Parulian (eds.), Social Protection in East Asia – Current State and Challenges. ERIA Research Project Report 2009-9, Jakarta: ERIA. pp.316-345.

### 3. Public Policy and Institutional Arrangements

#### Definitions

The National Social Protection Strategy provides definitions to several key terms as follows:

*Social protection* helps people cope with poverty and vulnerability. It consists of a broad set of arrangements and instruments designed to protect individuals, households and communities against the financial, economic and social consequences of various risks, shocks and impoverishing situations and to bring them out of poverty. Social protection interventions include, at a minimum, social insurance, labor market policies, social safety nets and social welfare services.

*Social insurance programs* are designed to help households insure themselves against sudden reduction in work income as a result of illness, maternity, employment injury, unemployment, invalidity, old age or death of a breadwinner. They include publicly provided or mandated insurance, such as social health insurance schemes to provide access to health care. Social insurance programs are contributory, meaning that beneficiaries receive benefits or services in recognition of their payment of contributions to an insurance scheme. The terms “social insurance” and “social security” are often used interchangeably.

*Social security* is closely related to the concept of social protection and can be defined as the protection that a society provides to individuals and households to ensure access to health care and to guarantee income security, particularly in the case of sickness, maternity, employment injury, unemployment, invalidity, old age or loss of a breadwinner.

*Labor market policies* include interventions to address direct employment generation, employment services and skills development as well as income support for the poor who are already working. Also covered is the setting of appropriate legislation on minimum wages, social security/social insurance contributions, child labor and other labor standards, to ensure decent earnings and living standards.

*Social safety net programs* consist of targeted interventions designed for the poorest and most vulnerable and financed out of general revenues – taxation or official development assistance (ODA). This is in contrast with social insurance schemes, which rely on prior contributions from their recipients. Safety net interventions include public works programs (cash for work and food for work); unconditional and conditional transfers (in cash or kind); and targeted subsidies designed to ensure access to health, education, housing or public utilities, such as water and electricity.

*Social welfare services* cover child care, elderly care, care for people with disabilities, home-based care and referral support for people living with HIV, return and reintegration of refugees, family preservation, family and community support services, alternative care, rehabilitation support for out-of-school youth, drug users, child laborers and psychosocial services, including in situations of emergency and distress. They are complementary to cash or in-kind

benefits and help reinforce outcomes generated by the former. Identifying points of contact between cash and in-kind transfers and social welfare services is essential in a coordinated and integrated approach to social protection.

The *Social Protection Floor* (SPF) is a basic guarantee of social protection for the entire population through a package of benefits and complementary social services to address key vulnerabilities throughout the lifecycle, for children, pregnant women and mothers, the working-age population and the elderly. Instead of focusing only on demand (for health, education, food, minimum income security, etc.), the SPF takes a holistic approach by ensuring the availability of social services.

## **Legal framework**

The Cambodian Constitution in 1993 provides a clear framework for social protection to the country's citizens. Every Khmer citizen shall have the right to obtain social security and other social benefits as determined by law (article 36). The State and society shall provide opportunities to women, especially to those living in rural areas without adequate social support, so they can get employment, medical care, send their children to school, and have decent living conditions (article 46). The State shall give full consideration to children and mothers. The State shall establish nurses, and help support women and children who have inadequate support (article 73). The State shall assist the disabled and the families of combatants who sacrificed their lives for the nation (article 74). The State shall establish a social security for workers and employees (article 75).

There are other laws related to social protection such as the Labor Law in 1998 (embodies most of the ILO conventions on core labor standards), the Insurance Law in 2000 (provides a legal framework for better regulation of insurance companies), the Law on Social Security Schemes for Persons Defined by the Provisions of the Labor Law in 2002<sup>14</sup> (focuses on the pension scheme which is in charge of providing old age benefit, invalidity benefit and survivors' benefit and occupational risk which is in charge of providing employment injury and occupational disease benefit), the Law on the Prevention of Domestic Violence and Protection of Victims in 2005, and the Law on Suppression of Human Trafficking and Sexual Exploitation 2008.

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<sup>14</sup> Article 4 of this Law

Persons covered by the Social Security Schemes in this law regardless of nationality, race, sex belief religion, political opinion, national extraction, social origin, membership of trade union or act in trade union are:

- All workers defined by the provisions of the Labor Law, if those persons perform work in the territory of the kingdom of Cambodia for the benefit of an employer or employers, regardless of nature, form and validity of the contract done or kind and amount of the wage received by the person thereof.
- State workers, public workers and every personnel who is not governed by the Common Statute for Civil Servants or by the Diplomatic statute as well as officials who are temporarily appointed in the public service.
- Trainee persons who are attending a rehabilitation center and apprentices shall be deemed as workers as provided in paragraph 1 of this article. A Prakas (proclamation) of the Ministry in charge of Social Security Schemes shall determine terms of implementation of these provisions.
- Persons working in self-employed professions. A Prakas (proclamation) of the Minister in charge of Social Security Schemes shall determine provisions in this paragraph.
- Seasonal or occasional workers. A Prakas (proclamation) of the Minister in charge of Social Security Schemes shall determine other particular necessary terms of implementation of the provisions after consulting with the Technical Council and the Governing Body of National Social Security Fund.

## **Government policies**

Before developing a national policy and strategy on social protection, Cambodia implemented social safety nets mainly funded by external sources to assist the poor and vulnerable to integrate and rehabilitate. The support programs include (a) food distribution to the areas and households facing food insecurity, (b) a feeding program at rural schools and a work-for-food scheme, (c) scholarships to support poor children to go to school, (d) public construction and infrastructure development in the areas hit by food insecurity and severe poverty, (e) a health equity fund and community-based insurance scheme to support the healthcare system for the poor, (f) a special healthcare program for the most vulnerable groups such as people with disabilities, the elderly, and orphans, and (g) other humanitarian assistances.

The Cambodian government has developed social protection policy with the overall aims to (a) develop and enhance human capital (health, education, livelihood), (b) reduce the vulnerabilities of poor people, (c) alleviate the impacts of climate change and natural disasters, (d) support the victims of natural disasters, (e) rehabilitate and integrate people with disabilities, orphans, poor widows/widowers, female-headed households, homeless people, veterans and their families, and the victims of drug addition, human trafficking, human rights abuse and violations, and (f) work in partnership with development partners and civil society groups to prevent crimes and provide justice to the local communities.<sup>15</sup>

The NSPS is necessary to promote the livelihoods of the people and to ensure achievement of the CMDGs. Rural economic development is to be achieved by rehabilitating and developing rural infrastructure, addressing seasonal unemployment and providing vocational training and microcredit support, as well as through interventions to ensure quality of life and social development.<sup>16</sup>

## **Institutional instruments**

The National Social Protection Strategy for the Poor and Vulnerable (NSPS 2011) was developed to provide better and more systematic social protection to the poor and vulnerable. The poor and vulnerable are those living below the national poverty line and those who cannot cope with shocks and/or have a high level of exposure to shocks. The NSPS consists of the following strategies.

- The poor and vulnerable would receive basic needs support including food, sanitation, water and shelter etc. in times of emergency and crisis;
- The poor and vulnerable children and mothers would benefit from social safety nets to reduce poverty and food insecurity and enhance the development of human capital by

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<sup>15</sup> Remarks by Prime Minister Hun Sen, available at <http://www.socialprotection.gov.kh/documents/publication/nsps%20book%20kh.pdf>

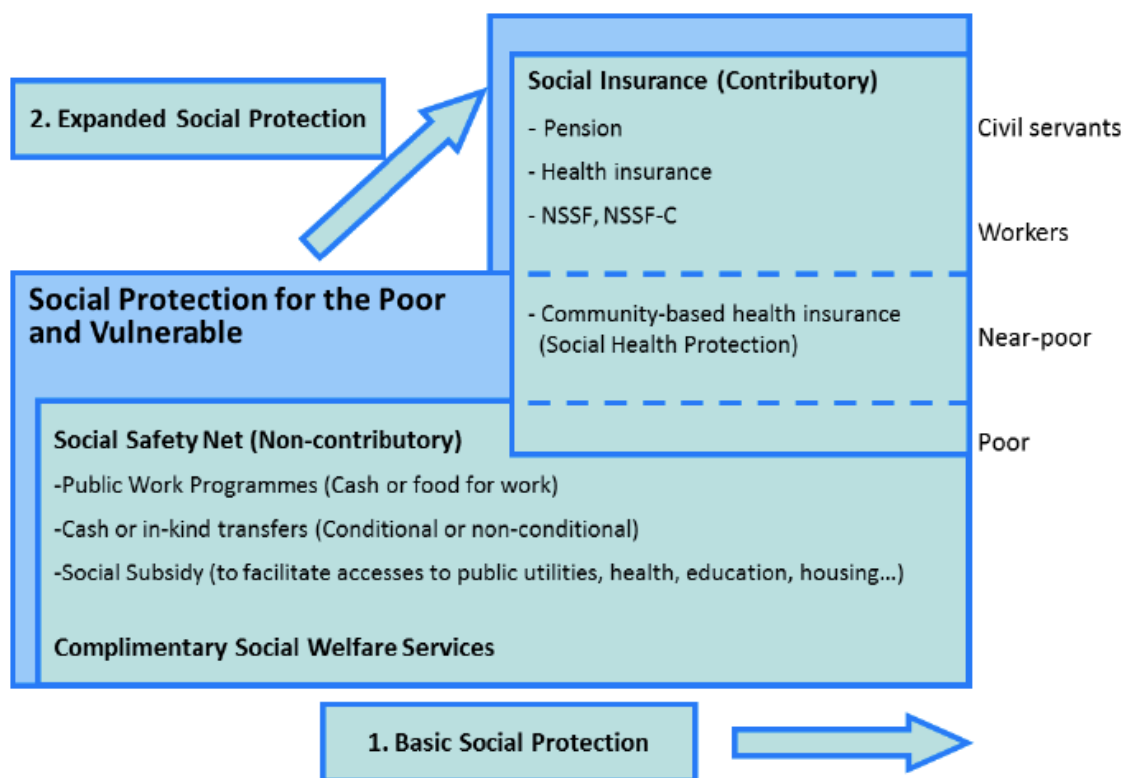
<sup>16</sup> Remarks by Deputy Prime Minister Yim Chhay Ly, Chairman of Council for Agricultural and Rural Development, available at <http://www.socialprotection.gov.kh/documents/publication/nsps%20book%20kh.pdf>

improving nutrition, maternal and child health, promoting education, and eliminating child labor;

- The working-age poor and vulnerable would benefit from work opportunities to secure income, food and livelihoods, while contributing to the creation of sustainable physical and social infrastructure assets;
- The poor and vulnerable have effective access to affordable quality health care and financial protection in case of illness;
- Special vulnerable groups, including orphans, the elderly, single mothers with children, people living with HIV, patients of TB and other chronic diseases, etc. receive income, in-kind, and psychological support, and adequate social care.

There are four key pillars under social protection: labor market policy, social insurance (contributory, higher income group), social safety net (non-contributory), and complementary social welfare services. For the social safety net program, it includes community-based health insurance, public work programs (cash or food for work), conditional or non-conditional cash or in-kind transfer, and social subsidies (to facilitate accesses to public utilities, health, education, housing.)

Figure 3. Gradual progression towards comprehensive social protection



(Source: NSPS 2011)

The National Social Security Fund (NSSF) offers basic social security to all workers in the private sector. The functional provisions include membership registration, receiving their



contributions, management of funds, processing and paying out benefits to qualified members or dependents.

The objectives of the NSSF are:

- To manage and administer the social security schemes according to the provisions of the law concerning social security schemes for persons defined by the provisions of the Labor Law;
- To ensure the provision of all benefits for the members of the NSSF (insured persons) for the purpose of providing income security in case of any contingencies such as old age, invalidity, death, occupational risks, and others;
- To collect contributions from the respective members and employers;
- To facilitate and organize the provision of health and social services for the members;
- To cooperate with the respective organizations involved to educate and promote strategies for occupational risk prevention; to promote measures on health and safety at the work place; to cooperate with relevant organizations to study and investigate occupational diseases; to manage the investment of social security funds.

In addition to the NSPS, there are other national action plans such as the National Action Plan to Suppress Human Trafficking in 2011 which has five strategic visions: (a) strengthening policy implementation and enhancing national and international cooperation, (b) preventing human trafficking, sexual and labor exploitation, (c) enhancing criminal justice mechanisms (suppressing and prosecuting), (d) protecting victims (including assistance in the repatriation, rehabilitation, and reintegration into society), with special attention to children, and (e) improving monitoring and evaluation. Moreover, the 2<sup>nd</sup> National Action Plan to Combat Violence Against Women (2013-2017) focuses on primary prevention, legal protection and services, laws and policies, capacity building, and monitoring and evaluation.

In September 2014, the government adopted the national action plan (2014-2018) on Early Childhood Care and Development (ECCD). The goals and objectives of the ECCD are: (a) all women are provided with care, health education services and nutrition during pregnancy, (b) all children have their births registered, are provided with care, regular health check-ups, adequate immunization and nutrition, and early learning, (c) all young children are ready to start grade one at age six, (d) technical staffs, caregivers, parents and guardians are provided appropriate knowledge on early childhood care and development, (e) all relevant ministries and institutions work together closely to address and deal with the issues concerning early childhood care and development, and (f) all young children from birth to school age shall enjoy physical, cognitive, mental and emotional development at their own home and centers which provide quality and sustainable health services, nutrition and education.

The ECCD contains the following key points: (a) ensuring provision of early childhood care and development services from conception to under six years of age, (b) ensuring that young children are provided with inclusive care and development, and (c) ensuring that relevant

ministries, public agencies and relevant civil society will work in synergy on early childhood care and development.

### **Implementing agencies**

The core ministries delivering social services to the people are the Ministry of Labor and Vocational Training (MoVT) – which provides a national social safety fund for the private sector employees, vocational training, and a child labor elimination program; the Ministry of Social Affairs, Veterans, and Youth Rehabilitation (MoSAVY) – which is responsible for the national social security fund for civil servants, services (for veterans, the homeless and destitute, victims of trafficking, children and youths, and people living with disabilities), emergency relief to those affected by natural disasters; and the Ministry of Women’s Affairs (MoWA) – which promotes women rights, eliminates all forms of violence against women and children, and empowers women in socio-economic and political life.

Other ministries also have specific social security net intervention policies and programs. The Ministry of Health (MoH) is in charge of health equity funds, community-based health insurance for the poor and vulnerable. The MoH has adopted and implemented several key strategic action plans such as the health strategic plan for 2008-2015, the strategic framework for health financing for 2008-2015, and the master plan on social health insurance for 2003-2005. The Ministry of Education, Youth and Sport (MoEYS) provides scholarship programs for the poor. The Ministry of Interior (MoI) plays a role in identifying entry points to ensure quality and equitable provision of social protection at sub-national levels.

There are several other state institutions assisting or complementing the implementation of social security programs. The Ministry of Agriculture, Forestry and Fisheries (MAFF) supports the social safety net programs through the improvement of food production and livelihoods. The Ministry of Public Work and Transport (MPWT), Ministry of Water Resources and Meteorology (MoWRAM), and the Ministry of Rural Development (MRD) work on rural infrastructure development and rural livelihood improvement. The Ministry of Planning (MoP) issues identity cards for the poor under the IDPoor program (the government’s targeting system for identification of poor households).

Other specialized agencies that provide social protection services are the Cambodian Red Cross and the National Committee for Disaster Management. These two agencies provide emergency relief to assist people to mitigate and deal with the effects and consequences of natural disasters.

The Council for Agricultural and Rural Development (CARD) created a social protection coordination unit in order to promote consultation, develop and institutionalize knowledge, coordinate social protection activities and funds, mobilize resources, and develop monitoring tools in order to effectively implement social protection and safety net policies.

## **Social protection intervention programs**

The study by the Asian Development Bank (ADB) categorizes the existing social protection interventions in Cambodia into three major components: social insurance, social assistance, and labor market programs.<sup>17</sup>

Social insurance consists of pensions and healthcare insurance implemented by the Ministry of Social Affairs, and the Veterans and Youth Rehabilitation and Employment Guarantee Fund.

For the social assistance, it comprises the food for emergency relief program, the people living with HIV/AIDS program, and the maternal and child health program. Most government expenditures on social assistance are in-cash or in-kind transfers to the poor, channeled through the Ministry of Social Affairs, Veterans and Youth Rehabilitation and the National Committee for Disaster Management.

The labor market programs include the vocational training program, the skills training program, and the food for asset program. Three ministries are collectively in charge of these programs: the Ministry of Labor and Vocational Training, the Ministry of Social Affairs, Veterans and Youth Rehabilitation, and the Ministry of Foreign Affairs and International Cooperation.

The National Social Protection Strategy for the Poor and Vulnerable Program (NSPS 2011) outlines four areas of social protection interventions including food and nutrition interventions, health interventions, education, technical and vocational training interventions, and social welfare and work conditions interventions.

### *Food and nutrition interventions*

- General food distribution to food-insecure areas in times of emergency;
- School feeding and take-home rations or food scholarships;
- Food for work programs addressing food insecurity, seasonal unemployment, chronic poverty and sustainable asset creation;
- Maternal and child health and nutrition programs, including transfer of fortified foods conditional on nutrition training;
- Food assistance to people living with HIV, TB patients and orphans and vulnerable children.

### *Health interventions*

- Measures to raise awareness on health promotion and vaccination.
- Health Equity Funds (HEFs) and Community Based Health Information Systems (CBHIs) addressing basic health protection for the general population.

### *Education, technical and vocational training interventions*

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<sup>17</sup> Asian Development Bank (ADB), The Kingdom of Cambodia: Updating and improving the social protection index, August 2012. <http://www.adb.org/sites/default/files/projdocs/2013/44152-012-reg-tacr-32.pdf>

- Scholarships – addressing poverty of schoolchildren;
- School feeding and take-home rations;
- Training programs of the National Fund for Poverty Reduction;
- Training programs of the Special Fund of Samdech Techo Prime Minister;
- Certified training programs of pilots on post-harvest technology and the skills bridging program;
- Training programs through technical and vocational training centers and community training programs of the provincial Department of Labor and Vocational Training;
- Training programs for indigenous and vulnerable people;
- Entrepreneurship courses for participants in training programs;
- Targeted training programs for particular stakeholders;
- Training and education programs through NGOs, associations and private sector actors recognized by the government.

#### *Social welfare and work condition interventions*

- Occupational health and safety system inspection to ensure appropriate workplace conditions;
- Expansion of occupational health and safety protection for small enterprises and the informal sector;
- Affiliation to professional associations to establish conflict resolution at the workplace and an Arbitration Council to promote harmony between employers and employees;
- Work injury insurance;
- Social safety net for migrants abroad;
- Prevention of all of the worst forms of child labor and forced labor;
- Social welfare services to special vulnerable groups, including disabled people, the elderly, orphans, etc.
- Research on employment and vocational skills required by the market to manage and integrate the labor force gradually and prioritize the division of labor in labor markets.

#### **ASEAN strategies and mechanisms in social protection**

The ASEAN Declaration on Strengthening Social Protection was adopted at the 23<sup>rd</sup> ASEAN Summit in Brunei Darussalam on 19<sup>th</sup> October 2013. It aims to:

- Support national policies, strategies and mechanisms to strengthen the implementation of social protection programs, as well as effective targeting systems to ensure social protection services would go to those most in need;
- Advocate strategies that promote the coverage, availability, comprehensiveness, quality, equitability, affordability and sustainability of various social protection services, including

the expansion of social insurance to the informal sector; strengthening social assistance programs for persons with disabilities, the elderly, children and other vulnerable groups; greater access to social protection programs and services, including vocational trainings as part of active labor market interventions and human resource development;

- Promote results-based and evidence-based national assessments and benchmarking of social protection delivery services in ASEAN Member States that would contribute to the progressive implementation, effective monitoring and evaluation, as well as optimum impact of social protection;
- Explore and develop assessment tools and regional statistical indicators where appropriate to measure the impact of social protection to the holistic development of vulnerable groups for future planning towards available accurate baseline data collection;
- Allocate adequate financial resources for social protection in line with national targets and subject to the capacity of each Government;
- Strengthen the capacity of government officials, communities, service providers, and other stakeholders for better responsiveness, coordination and effectiveness of social protect and delivery services at regional, national and local levels;
- Collectively accelerate the progress towards Universal Health Coverage (UHC) in all ASEAN Member States by strengthening capacity to assess and manage health systems to support UHC through sharing of experiences, information and experts;
- Foster the involvement of the existing mechanisms of ASEAN sectoral bodies, including the ASEAN+3 Network on Universal Health Coverage, in promoting social protection in the region through projects and activities to support ASEAN Member States in fulfilling the social protection of the people, particularly the poor, persons with disabilities, older people, children and other vulnerable groups;
- Promote multi-sectoral responsiveness of social protection through consultations, sharing of information on good practices and policies, knowledge management, cooperation, and coordination on social protection amongst the relevant ASEAN sectoral bodies with the support of the ASEAN Secretariat. In this regard, the relevant ASEAN Ministerial Sectoral Bodies are tasked to convene an inter-sectoral regional consultation meeting;
- Assign the ASEAN Ministerial Meeting on Social Welfare and Development (AMMSWD), with the support of Senior Official Meeting on Social Welfare and Development (SOMSWD), as the focal point for inter-sectoral cooperation on social protection at regional level, while acknowledging the different national coordinating mechanisms in ASEAN Member States;
- Build and strengthen the networking and partnerships within and among ASEAN Member States as well as with Dialogue Partners, UN Agencies, civil society, private sectors, development partners, and other stakeholders in supporting adequate resources and effective implementation of the commitments.

#### **4. Constraints and Challenges**

Implementation gaps, institutional inefficiency, and limited financial resources are the main constraints and challenges in implementing social safety nets in Cambodia.<sup>18</sup> It is argued that: “Social interventions have been fragmented, limited in scope, episode- and donor-driven and unsustainable.”<sup>19</sup>

#### **Conceptual framework**

Social safety nets are just part of social protection policy. At this stage, Cambodian policy on social protection is confined to social safety nets designing programs and mobilizing resources to target the poor and most vulnerable especially in coping with shocks and crises. It needs to gradually expand its conceptual understanding and policy coverage to incorporate a broader and more comprehensive social protection.

For the long term solution to social and economic issues, Cambodia should consider developing and promoting a national welfare state and socially just development. It needs to carry out comprehensive reforms including taxation, labor market, pensions, health care, and education/training to serve the interests of the people not the elites. It is argued “protection against the risk of poverty and ensuring education/training must not be considered an act of charity of the solidarity of the virtuous.” It is part of social policy. People’s involvement and participation in social and political life also constitute social protection.<sup>20</sup>

Addressing social exclusion and injustice requires a structural social policy. It needs to address the sources and causes of structural vulnerabilities and power hierarchies. “In order to tackle multidimensional vulnerability in a sustainable way, it is vital for social protection programs to be designed and governed so as to promote social inclusion and accountability.”<sup>21</sup>

#### **Governance issues**

Across Southeast Asia, governance is the main challenge in implementing social protection policy. Four key governance issues are poor coordination within the overall social protection system, unclear institutional responsibilities with a lack of implementation capacity, conflicting systems of accountability, and inadequate monitoring and evaluation.<sup>22</sup>

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<sup>18</sup> Sann, Vathana (2010) “Social protection in Cambodia: Toward effective and affordable social protection for the poor and vulnerable”, in Asher, G., S. Oum and F. Parulian (eds.), *Social Protection in East Asia-Current State and Challenges*. ERIA Research Project Report 2009-9, Jakarta: ERIA. Pp.316-345.

<sup>19</sup> CDRI 2012, p.68

<sup>20</sup> Friedrich Ebert Stiftung (FES) (2012) *Social Democracy Reader 3, Welfare State and Social Democracy*.

<sup>21</sup> Jones, Nicola and Shahrokh, Thea (2013) *Social protection pathways: shaping social justice outcomes for the most marginalized, now and post-2015*. ODI Background Note April 2013. Available at <http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8390.pdf>

<sup>22</sup> Van Stolk, Christian (2010) *To strengthen the governance dimension of social safety net programs in the ASEAN region*. WR-753-WB, April 2010. RAND Europe.

The administrative challenges include beneficiary selection, processing of applications, benefits payment/reimbursement, verification and monitoring of the implementation of the social protection programs and projects, and exit of beneficiary.

Beneficiary selection (entry) refers to the entry of the beneficiary in the system and reflects not only on the targeting of the social safety nets program but also on the procedures in place on the ground for selecting beneficiaries. This stage also reflects on communication strategies in place to tell potential beneficiaries about the program and eligibility requirements and the training beneficiaries may receive on their rights and responsibilities under the program.<sup>23</sup>

The processing of applications (registration and eligibility verification) stage refers to the actual process of registration of benefits, how files are processed at different levels of the administration and what verification takes place on the eligibility of the application at the outset of the claim.<sup>24</sup>

The payment of benefits stage represents not only the delivery of payments but also the process of determining the amount, frequency, and mechanisms for transfer of funds.

Verification and monitoring refers to what monitoring and verification takes place during the period of the claim and at what level. This includes management information systems, audits, quality control mechanisms, complaint management, social controls, and evaluation of impact assessments. It also reflects on policies with regards to consequences of non-compliance.

Finally, exit of beneficiary refers to how beneficiaries graduate from the program.<sup>25</sup>

There are several gaps in implementing social protection and social safety nets in Cambodia.

- Programs are often implemented in parallel with the government structure, failing to build capacity in local government to gradually take over safety net management, therefore generating a vicious cycle of low local capacity and sustained parallel implementation of programs.
- Social safety net program lack of clarity around responsibility and accountability. Limited coordination among social protection interventions has resulted in uneven coverage, duplication of efforts and lack of sustainability and overall impact.
- Geographic coverage of existing programs, even the largest ones, is far from universal. Moreover, programs do not necessarily prioritize poor areas.
- Targeting has not yet been mainstreamed into safety net implementation and many safety net programs still rely on *ad hoc* targeting procedures whose accuracy has not been investigated, adding to transaction costs and inefficiencies.
- Feedback and complaint resolution systems – a central pillar for guaranteeing good governance, transparency and effectiveness of safety net interventions – tend to remain underdeveloped. Only few programs have been evaluated in relation to the effectiveness

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<sup>23</sup> Van Stolk, Christian (2010).

<sup>24</sup> Van Stolk, Christian (2010).

<sup>25</sup> Van Stolk, Christian (2010).

and feedback systems.<sup>26</sup>

### **Resource constraints**

- As an underlying challenge, the budget for safety net implementation remains low, with the majority of funding provided by development partners and earmarked for interventions that are often implemented in parallel with the RGC system.<sup>27</sup>
- The current fiscal policy is not oriented towards social protection given the state budget for the education and health sectors are marginal. The taxation system does not function well, leading to a big loss of state revenue. In turn, it creates a serious shortage of national budget allocated to support the poor and vulnerable.
- Implementing social protection and social safety nets mainly relies on funding resources from the donor community. This illustrates a lack of sustainability.

### **Knowledge gap**

- Few programs and institutions are actually collecting critical monitoring information beyond inputs, outputs and the mere list of beneficiaries, which makes it difficult to assess the effectiveness of ongoing programs and improve them on an ongoing basis. Even fewer are using monitoring data to improve their procedures on a continuous basis. Moreover, there are few rigorous and thorough evaluations of existing safety net interventions, making it difficult to assess how well they perform by international standards and where there are areas for improvement. Collecting information through the program is limited.<sup>28</sup>

## **5. Conclusion and Policy Recommendations**

Cambodia is facing major sources of vulnerability. Women, children, the elderly, and people with disability are most vulnerable groups. Limited access to healthcare and education are the two main issues being faced by the poor and vulnerable.

Social protection is the core element in promoting inclusive growth and sustainable development. Cambodia has institutionalized social protection policy frameworks and action plans since 2009 after it was seriously hit by the global financial and economic crisis.

In 2011, the government issued policy guidelines to implement social protection for the vulnerable and the poor. However, the implementation of social protection is not effective and the coverage is very limited. It is characterized by fragmented administration with various ministries, departments and organizations providing the protection.

However, the social protection policy is limited to social safety nets. It needs to expand its policy coverage and action plan to incorporate wider social, economic, and political reforms to address the structural issues of vulnerabilities, social justice, and people's participation.

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<sup>26</sup> National Social Protection Strategy for the Poor and Vulnerable Program, Royal Government of Cambodia.

<sup>27</sup> National Social Protection Strategy for the Poor and Vulnerable Program, Royal Government of Cambodia.

<sup>28</sup> National Social Protection Strategy for the Poor and Vulnerable Program, Royal Government of Cambodia.



Implementing the existing social protection programs remains very limited due to resource constraints, institutional weakness, knowledge gaps, and poor coordination. Capacity building and skills development are therefore needed to effectively deliver social protection programs.

Resources are needed to implement incentive-based cash transfer schemes and in-kind assistance with cash-based interventions. Education and healthcare reforms are the two priority areas that need more attention and investment.

The Asian Development Bank recommends that the overall policy should focus on:

- Developing food for work programs;
- Increasing the coverage of labor market programs;
- Giving greater emphasis to pro-poor targeting;
- Strengthening and increasing the coverage of educational assistance schemes;
- Investigating the needs for targeted health assistance programs.<sup>29</sup>

According to the World Bank, to reduce poverty and vulnerability in Cambodia, it should:

- Improve and upgrade the quality of basic rural infrastructure such as roads, irrigation schemes, electricity supplies, and water and sanitation.
- Support children in rural areas to start school at a younger age and broaden access to education among minority communities are keys to reducing poverty.
- Expand scholarship programs, school feeding, targeted cash transfer and similar programs that have been shown to help reduce secondary school drop-out rates.
- Promote an integrated program to reduce child malnutrition, with systematic monitoring of child growth by health facilities, promoting community-based programs to reduce open defecation, and improving feeding habits.
- Increase the coverage of the Health Equity Fund – a scheme that provides free access to health care for the poorest – and raise public awareness of the importance of reducing child malnutrition.
- Impose tighter controls on private providers and suppliers of medicine outside the public health system to combat counterfeit drugs and improve health care safety.
- Promote programs to enhance the profitability of rice production by providing improved seeds and more effective rural extension services to help farmers shift from subsistence to commercial farming.<sup>30</sup>

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<sup>29</sup> Asian Development Bank (ADB), The Kingdom of Cambodia: Updating and improving the social protection index, August 2012. <http://www.adb.org/sites/default/files/projdocs/2013/44152-012-reg-tacr-32.pdf>

<sup>30</sup> World Bank News (February 20, 2014) “Poverty has fallen, yet many Cambodians are still at risk of slipping back into poverty, new report finds.” <http://www.worldbank.org/en/news/press-release/2014/02/20/poverty-has-fallen-yet-many-cambodians-are-still-at-risk-of-slipping-back-into-poverty>



# Reflection on the Housing Security Program in China

Wang Jing<sup>1</sup>

## 1. Introduction

Housing plays an important role in the social and political spheres in every society. It is a critical element in creating a stable community. For a single family, housing expenses usually account for a large portion of household expenses. Housing could be a sector that stimulates the national economy. Housing policy and subsidy programs are developed in most countries in response to specific macroeconomic or political situations. The availability of financing for housing is a critical component in housing affordability and the efficient operation of a housing system. When societies urbanize and disposable income increases, housing demand and standards also increase simultaneously. However, generally social acceptable housing is expensive compared to average household income or social resources. In some developing economies, the access to long term financing to pay for a house over time is especially important unless the state assumes the responsibility or pays for the housing asset directly, like socialist planned economies before the 1980s. In the absence of an effective system of housing financing, whether long or middle-term, households have to finance their homes from savings or depend on family support. They must build their homes over long periods or settle for a lower quality structure, often extralegal, which often leads to inadequate access to clean water, sanitation and community services. This epitomizes the situation of migrant workers in most larger cities in China.

Unfortunately, how to intervene in the housing finance system is not well analyzed in the social policy research, which is usually based on a vague belief that housing is a basic need and a merit good, and requires general government subsidy. Subsidy in housing finance can be fairly easily achieved at a national level from a regulation perspective, and is therefore usually a first policy choice. However, without understanding the specific reasons underlying the housing affordability problems of the poor population or due to a lack of knowledge of the bureaucratic political system, subsidy housing programs are often inappropriate and inefficient. This is the case in many developing countries as housing subsidies are often delivered through politically attractive programs which come from the politburo, but are not adapted to the local economic conditions, or stipulate local government incentives, which end in failure.

This paper will take China's housing policy as a case, as the distinctive trajectory of housing provision in China is under the influence of the struggles between socialism and market mechanisms. The research on China's housing policy will reflect some common features in the

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transitional countries, since China has been undergoing the transition from planned to market economy during the last decades. We will review housing policy during this process. First, the institutional changes in each country will depend on its traditions to some extent, and housing provision in the planned economy still affects some local practices regarding the housing system, so the first part will comb the trajectory of the housing policy transition from the 1980s to the present.

After reviewing the historical transition of China's housing system, we will then analyze the framework of China's current housing policy. We will mainly discuss the three major programs that the Chinese government has developed for low income populations in urban areas. The three housing programs are the Economical and Comfortable Housing Program (ECH), the Housing Provident Fund Program (HPF), and the Cheap Rental Housing Program (CRH).

Along with the rapid urbanization, the urban population becomes more stratified than in the 1980s, when most of the population belonged to a work unit, and the work unit could provide nearly all aspects of welfare. The most important change in urban population structure is the rising number of rural-to-urban migrants. The Chinese government has made significant efforts to deal with the affordability problems on housing demand, but due to some deep-rooted structural problems, there is still a large amount of population with under supply, despite the concern of local governments. We will discuss the structural and institutional reasons for the under supply of social housing in urban areas in the third part.

In the final part, we prepare to discuss some notions about how to design an appropriate housing program adapted to a specific political system, which could provide some policy implications to other countries, so we will also attempt to propose some policy suggestions on the basis of analysis of China's housing policy.

## **2. The Background of Housing Policy in China**

Generally speaking, the transformation of housing policy in China can be regarded as a special case of liberalization transition (He & Wu, 2009), where the decentralization of state governance and the deregulation of urban economy are combined with the path-dependent housing marketization to reshape the production and reproduction of the urban space (Chen, 2011). We will discuss several major milestones in China's housing reform.

In the planned economy, there is no free housing market or private housing transactions. All of the housing are governed by the housing management department and work unit. Along with medical care and pension security, the allocation of low-rent housing was one of the main pillars of "work unit socialism" (Liu, 2000). Since all of the productions are priced by the central government, the rent price is lower than the market price, and couldn't even cover the cost of the basic maintenance. In the whole period of the 1980s and 1990s, housing shortages and bad housing conditions were a very central concern for the common people. According to a survey

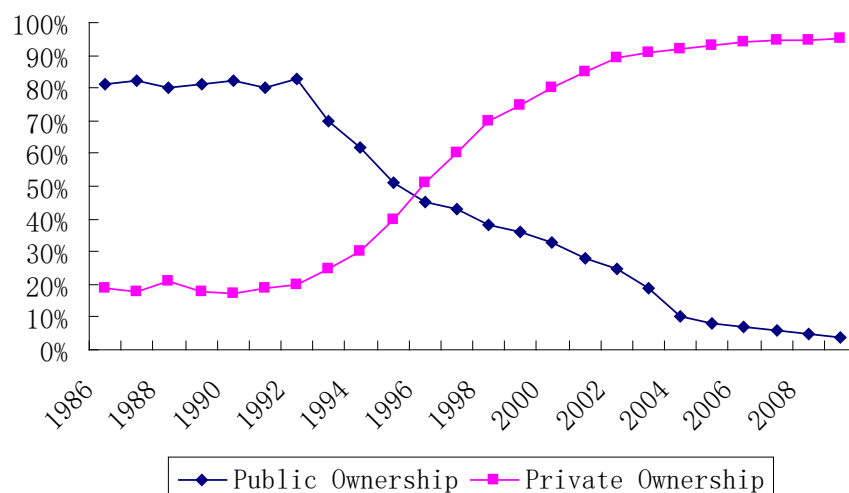
from the Chinese Academy of Social Sciences in 1988, the average living space per household was only 8.0 m<sup>2</sup>, and only 4 percent of households had their own toilets and bathrooms.

From the end of the 1980s, the Chinese government began to reform its housing system, which aimed at reforming the general urban renting system. As described above, the rent price was far below the cost during the planned economy, and the reform of the first wave hoped to raise the rent of public-owned housing while adding a housing subsidy to salaries simultaneously so that the public responsibility for housing supply could be retreated. However, this in fact is easier said than done, especially with regard to reforming the allocation institution embedded in the planned economy, which may affect some interests of the large work unit. And indeed, large work units still play an irreplaceable position in housing provision in urban areas. First of all this is reflected in the invisible housing welfare through discounted price to employees, which generates inequity in housing distribution on the first round.

In the 1990s, the central government finalized the housing reform framework. As a guiding principle, the documents state explicitly “commercialization and socialization of housing,” that is, to abolish the welfare housing system through housing privatization and rent reform, gradually setting up a functional housing market. Regarding the instruments of this round of reform, the government decided to build a multi-layer housing provision system for different income groups, with “market price” for higher-income households, and the property rights belonging to the purchaser. Meanwhile the middle-income and low-income households could purchase subsidized housing through the governments' special housing program, and the owner only acquired partial property rights, and reselling to third parties at market price was restricted. With regards to the institutional heritage, the government announced strict regulations toward to the intervention of the work units, that is, terminating work units' in-kind housing distribution, prohibiting work units building housing for employees, as well as the other invisible housing benefits. Nearly at the same time, central governments set up another housing institution still based on work units, which is the Housing Provident Fund introduced from Singapore's housing financing system. The work units and employees contribute a certain percentage of employees' salaries, and the function of the work units shifted from direct housing provision to partial housing financing, which alleviated the burden of the work units.

China has finally propelled the housing production and consumption toward a market system. Today, private market transition is the major channel for Chinese households. According to national statistics, China's annual investment in real estate was about 746 billion RMB and accounted for 7 percent of national's GDP. As the housing industry becomes the new engine of the economy, urban residents' living conditions have also significantly improved. The floor space per capita has increase from 8.0 square meters in 1988 to 29 square meters in 2010. The homeownership rate in China reached 80 percent in 2010.

Figure 1. The change of housing ownership during 1986-2008



However, this significant progress has not been enjoyed by all social groups, and those emerging poor urban that are marginalized by market power have been excluded from the economic developments. With escalating housing prices, more and more urban residents are falling into housing poverty. As many researchers have pointed out, the succession of the old institutions and power conversion, which refer to the unjust elements of the pre-reform institutions, such as the Hukou household registration system and inequity among work-unit housing allocation, have remained influential factors in the process of housing transition (Li, 2000; Logan et al., 1990). For example, although work units no longer build housing directly for their employees, they continue to play an important role in their employees' housing consumption, either through cash-based housing subsidies, or through their contributions to the Housing Provident Fund. In fact, the continuous participation of work units has been a major cause of the increasing inequality in China's housing system. Moreover, because of the unbalanced pace of development in different provinces in China, the central government recently made a national framework of housing policy, giving some adjustment space for local governments when implementing the specific housing programs (Huang, 2004). Usually, central governments guarantee only very limited financing, and local governments are required to bear most of the costs involved in the reform. As a result, this generates significant variation and inequity at the regional level (Wang, 2005).

### 3. Housing Policy Framework in China

In past few years, the Chinese government has been juggling between market oriented economy and planned economy, which is reflected in its housing policy reforms, pushing forward the reform of housing marketization, and simultaneously making efforts to guarantee housing provision for low income and low-middle income households with subsidized housing. While the

two goals are conflicting in most situations, economic targets make local governments put excessive emphasis on housing privatization, using it as a growth pole, yet housing security is usually being neglected. This is the true situation of the current housing market, that is, after pushing hard for housing privatization reform for nearly twenty years, the central government has to face the challenges of acute housing inequity and housing poverty problems among the urban poor population, which is the primary cause for the launch of a series of “low-income housing” programs.

Currently there are three tiers of housing provision in China. The top tier is a private housing market the government is keen on pushing hard for housing privatization, while the middle tier and lowest tier are introduced to provide affordable housing and low rent housing to people with relatively low incomes and the poorest. The specific middle and lowest housing programs are: the Economic and Comfortable Housing (ECH) program, the Cheap Renting Housing (CRH) program, and the Housing Provident Fund (HPF) program. This report will mainly discuss the middle and lowest tier housing programs in China, which concentrated reflecting the Chinese housing policy in the post-reform era.

### **3.1. The housing financing instruments for the middle-tier families**

The middle-tier populations mainly include the low-middle income class in urban society, who are keen to have homeownership but lack purchasing power. The Economic and Comfortable Housing (ECH) program only aims to serve middle income urban families who cannot purchase houses at market price. The ECH program is a major housing supply system after the 1994 reform, and has special features different from previous public housing initiatives. Firstly, ECH is targeted at home ownership rather than renting, with sales to qualified families through the market. Secondly, some ECH units were built by real estate developers, while others were developed by special real estate companies that are subordinate to large work units (Di et al., 2008). This is a win-win cooperation between local government and real estate developers. Local governments provide low-cost land to developers as well as reducing various development fees and real estate taxes. In exchange, the developers should keep the profits not beyond a certain limit (Liu and Xie, 2000).

The ECH housing program is aimed at covering over 50% percent of the middle income population based on the policy framework. This ambitious aim reflects a motive behind it that the government wishes to use ECH as an instrument to stimulate the economy after the Asian Financial Crisis. Thus the goal of this housing program is not targeting the low income population, while concentrating on stimulating housing consumption. In the end, the wealthy households benefit a lot from this program, pushing the housing prices higher than the affordability of middle and low-income families (Cai, 2009). Besides that, local government is the entity that truly implements the program, and they are prone to compromise with developers and wealthy local buyers, which is also the most cost-effective from a local standpoint. As a result, the prices of

ECH units are kept at a higher level beyond the reach of low income population (Duda et al., 2005). A research by Guo (Guo, 2012) shows that the ECH housing price in Nanjing is 10 percent higher than that of a middle income family.

The Housing Provident Fund (HPF) program is a compulsory housing saving program which was brought in from Singapore. Employers and employees should both equally finance a proportional of salary to their account. Employees could get a low-interest loan when they are preparing to buy an apartment. In general, HPF is also a policy instrument for promoting homeownership. Employees can purchase market housing using a portfolio plan, which includes HPF loans, commercial mortgage loans, and other financial resources. Based on the above analysis, HPF is quite different from the public allocation system in the planned economy, in that the public provision is replaced by cooperative contribution from employers and employees. Thus HPF has played a significant role in the transition of China's housing reform.

In 2012, the HPF program covered 70 percent of all salaried workers in urban areas, while the participation varied across different areas. Because the HPF program is salary based, horizontal inequality is inherent in its design; workers with higher salaries receive larger employer matching contributions, and certainly can get larger loans when they are purchasing homes. However, the lower income group could not even buy housing, not to mention using the HPF fund. Simply due to reasons of affordability in low income families and usage restrictions, a large amount of funds were sitting in the bank account.

### **3.2. The housing financing instruments for the lowest tier families**

As the literature review in the second part, the Chinese government puts economic development above all the other targets, and the housing policymaking is also incorporated into this theme. Most of government efforts focus on promoting homeownership, while placing less attention on the housing needs of low-income renters. The practical goal of housing policy is to promote economic growth, and housing consumption could simply be a growth pole in stimulating the economy especially after the Asian Financial Crisis.

Even if the ECH and HPF have been established since 1998, there are still a large proportion of urban households which can't afford to purchase ECH units or rent market housing. Especially after the removal of restrictions on migration from rural to urban areas, many large cities have seen a massive influx of migrant workers from rural areas. As the welfare for rural residents is historically inferior to that of urban residents, and because of their Hukou status, they are restricted in lower-paid informal sectors, and most rural migrants immediately become members of poor populations in cities (Fan, 1999). Meanwhile, the marketization and privatization induced by the economic reform has resulted in a dramatic restructuring of the urban economy, which means that some state-owned companies have to compete on market terms. As part of this restructuring process, a great number of urban residents have been laid off or retire earlier (Yao, 2004b). All these forces combined to form the lowest-tier urban population, who



have the least probability to achieve homeownership in short term, and also lack the economic ability to rent market housing. Yet as stated above, the central government has not made a special effort to accommodate the housing needs of the growing low-income population. As a result, nearly 10 million urban households still live in poor conditions, that is 10 square meters per capita, most of whom are rural-to-urban migrants (MHUDC, 2009).

In the beginning of 2000, the central government decided to face the discontent among the low-income households in urban areas, and launched the related regulation on cheap rental housing. Generally speaking, the CRH can be provide in three forms: the first, "controlled rents with in-kind provision," where governments or capable work units provide housing with controlled price; the second, "rent subsidy," where low-income families can rent private housing from the market but subsidized by a cash subsidy; and the third, "rent reduction," where the low-income families who have already rented houses can get comparative rent deductions. In 2010, the central government has been promoting "Public Rental Housing," which is distinguished from the CRH program. The PRH is mainly targeting low income households, and the beneficiaries of PRH are more diverse than CRH, which include newly graduated students, new employees, and even include some migrants with residence permits in the ingoing cities. One of the apparent differences in PRH is the coverage of the migrant population, which is the first housing policy practice breaking the Hukou restriction.

Considering the development of CRH, it has the same common features as ECH and HPF, which mostly rely on the local government funding for implementing the program, while the central government only accounts for a small part of financing responsibility. For CRH, the conditions are even worse than the previous ownership housing programs (ECH & HPF), which led to unbearable burdens on local government compared to ECH where the burden of financing could be shared with developers. The CRH program clearly targeted the low-income households, the local government has allocated subsidies for its production as well as subsidies for renting, and strict development standards were also established. As a result, the program has grown very slowly. Local governments were reluctant to push the CRH program not only because of its financing responsibility, but also worries about the revenues from land sales, in other words, the land occupied by the CRH is the opportunity cost of commercial land usage. Predictably, most of the CRH programs are concentrating in the least attractive areas, which is also useless for urban working populations. Until 2006, only 55,000 low-income households have been covered by the CRH program, and together with other public housing programs, the total starts of new public housing only account for less than 1 percent (Tan, 2009).

In 2007, the central government revived the CRH program when the macro monetary policy on controlling housing prices did not work. For the new CRH program, the central government set up an earmarked subsidy fund through two agencies: The National Development and Reform Commission and the Ministry of Finance. The total fund was 48.1 billion RMB during 2007 and 2008. To resist the shocks of the global financial crisis in 2008, the Chinese government invested

400 billion to subsidize housing development, aiming to addressing housing inequality problems. But the housing industry was over-heated, the ambitious goal for poor residents' housing wasn't achieved in the end. With the escalating housing prices, the central government launched an important document, the so-called New 10 Articles, which demonstrated the clear position and decisive resolve of the provision of affordable housing. Furthermore, the central government made a strong commitment to provide 5.84 million additional units of public housing in 2010, and 36 million for the period 2011-2015.

#### **4. Analysis of the Performance of Housing Programs in China**

Although the Chinese government has announced an ambitious commitment to poor residents in urban areas in recent years, the low-income housing programs implemented in cities didn't seem successful up to now. Some of the structural reasons for the bad performance of the housing programs in China are considered here.

##### **4.1. Problems in housing policy designing and implementation**

The first reason is the policy failure in housing policy targets and design, that is, the central government did not set explicit objectives as well as efficient instruments to meet the housing needs of the low-income population. In the past two decades, economic development is the primary task for both central government and local government. This resulted in a lack of a long-term plan adapted to the pace of dynamic low-income population structure and their diversified housing needs. After the financial crisis, the Chinese government needed new growth driving forces, then housing construction and consumption of private housing became prosperous in the next 10 years since 1997. After the termination of public housing and commercialization of private housing, the private ownership housing started increasing dramatically. Ironically, while there was a rapid market expansion in private housing, the public housing kept shrinking, i.e. ECH and CRH were virtually ignored in practice. In the phases of market-oriented transition, it is fair to say the government should intervene in the areas where there may appear to be market failure, such as in public housing supply. However, the Chinese government still adopts a path-dependent policy path, tightening the credit and making strict regulations on land policy. Though many instruments have been tried, the housing prices are still kept at a high level, while the public housing has insufficient supply, and housing affordability among the low-income population become a serious problem.

In China, there was more and more distrust in government during the period from 2000 to 2010, though the average standard of living has changed a lot during the market reform, while more and more inequity problems were raised during the market process, while the government's targeting is one of the reasons for the public discontent. Housing is a wealthy asset for most families, if more and more real estate are grasped by a minority of the people, the housing prices are de facto monopolized by some interest group. During the past ten years, the government

strategies are still stagnating for fear of interrupting the economic growth rate. However, after 2010, the central government couldn't ignore the problems any more, and new documents that include more strict housing control were launched in 2010, in which the government strictly controls housing prices, and explicitly defines the responsibility of housing financing toward public housing.

Generally speaking, most of the public programs on housing have not worked up to now. Firstly, the Economic and Comfortable Housing, which should target low income households with housing difficulties, finally benefits the households who can afford the housing, and most of the housing subsidy has flowed to the wealthy households or worked in good work units. By 2013, the 'Economic and Comfortable Housing' is gradually retreating from the housing market and being displaced by another housing project called 'price-ceiling housing,' in which housing prices refer to the market price, but 30 to 40 percent lower than the market price. Secondly, the 'Cheap Renting Program' is also an instrument that the government hopes will counter the heating housing market. Because renting has no threshold, it could work as a minimum housing safety net for the lowest income groups in urban areas. The central government's ambition is to cover all of the households in need of housing assistance. This goal can hardly be said to have been achieved up to 2014, especially considering the large numbers of rural-to-urban migrants still living in some suburb, in poor condition houses. While from a positive perspective, the urban households with Minimum Living Standard Assistance<sup>2</sup> (MLSA) and housing difficulties have been covered by the program.

Currently the Chinese government has set up the public housing framework, with Economic and Comfortable Housing and Price Ceiling Housing for middle incomes, and Cheap Renting Program for low incomes. And yet for all that, there are still some households which are excluded from the two programs. In economics, these effects, called "cliff effects", mean that there is an amount of the population whose status is between two different housing programs, while subsidies are often designed with rigid income standards or cut off points, or often come with strings attached. Households with incomes lower than the standard cut-off points qualify for a considerable subsidy compared to households near the cut-off point, and this often leads to new inequitable factors. In China, there are a really huge number of households in the policy vacuum. For ECH and CRH, the migrant workers couldn't access to these public housing programs before 2010 until the launch of the Public Renting System. PRH has been open to the middle income population with temporary housing difficulties, even including migrants. The local government should supply enough public housing storage for the PRH demand. In this sense, the government seems to have returned to its position at present.

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<sup>2</sup> The MLSA program is a safety net for the urban poor, households who qualify for MLSA received a monthly allowance from government to ensure their basic living standard.

In general, during the past 30 years, housing policy transition in China reflects a strong market-oriented reform tendency. The government abolished the sluggish public housing provision, adopted a marketization principal for housing allocation, which improved the allocation efficiency of production factors, and improved China's overall living standards. But from another perspective, the housing affordability and housing inequity is becoming a serious problem like any market economy, which needs effective government intervention to compensate for the market failure. However, the Chinese government has conflicting economic and social goals, and most of time inclines the policy balance toward economic goals. Thus the government missed the opportunity to design a fair housing system for the whole urban population regardless of social class in the beginning of urbanization, which has left its mark until today, with the continuous implementation of housing policy programs by patching faulty programs one by one. Anyway, the government has established a three-tier housing program for middle and low income urban population, with CRH, ECH for low income households, PRH and controlled housing for middle income households, and commodity housing for the rest.

#### **4.2. The impact of institutional succession and power conversion**

In China, even though the central government abolished the planned economy, the institutional imbalances such as the division of Hukou and the inequitable allocation of resources among or within work units have still remained significant factors in housing provision.

The Hukou system is a main characteristic of Chinese institutions, with nearly every social policy affected by the Hukou system. In comparison with other nations where Hukou merely acts as a statistical or recording system, China's Hukou system was used for status identification, and most social welfare was bound with Hukou status during the planned economy. Until the 1990s, the classification of rural and urban still affects the access to many welfare schemes, such as pension, medical care, employment as well as public housing programs. Those rural-to-urban migrants have an inbuilt disadvantage compare to local residents with urban Hukou (Wang & Zuo, 1999; Chan & Buckingham, 2008). Since the beginning of 2000, the governments realized the unequal treatment to the migrants, and made some efforts to correct this policy. With the authority for Hukou admission handed over from central government to local government in the late 1990s, some cities were encouraged to take measures to eliminate the distinction between the rural and urban Hukou system. However, local governments usually tend to grant urban Hukou to those who are rich or well educated or who have family members among the urban citizens. What's more, because different provinces have various welfare levels, the equalization policies are usually open to the migrants in the same provinces. Until today, Hukou is still a big issue in China, and the mass of the migrants are still floating in urban cities, which are excluded from most of the social welfare programs (Lu & Song, 2006; Chan & Buckingham, 2008).

With regards to the relationship between Hukou and public housing programs, migrants without local urban registration are unable to access low-income housing, including PRH. In some

larger cities, there is a strict standard to apply for the low-income housing, such as in Beijing, seven years of local registration are the basic condition to apply for the low-income housing. Even though some qualified migrants lived in the same cities for quite a long time, and are allowed to access PRH in the end, the strict criteria and complicated procedure make it unattractive to a small proportion of skilled migrants. Currently there are two kinds of houses that migrants usually choose to live in big cities, one is the factory dormitories, and the other is private housing in suburb villages. That is to say, the government ignored the housing conditions of migrants for a long time. In 2006, the central government recognized the serious problem of migrants' inhabited communities, and decided to improve migrants' housing conditions for the first time.

However, the same financing problems as we have discussed above, as the central government constituted the policy framework but did not guarantee to take responsibility for the financing, and left the work units to finance the migrant workers. In fact, some work units didn't have the capability to meet the migrants' housing needs. In 2010, the Ministry of Housing and Urban-Rural Development issued a new document, which defines that migrants who have stable jobs and who have lived in the same city for a number of years can be eligible to apply for PRH. Some big cities even take the policy further, such as Xiamen and Chongqing, where migrants are allowed to apply for all types of low-income housing. But this kind of policy needs local government to match the considerable budget for low-income housing building and subsidy, and most cities are still immobilized. In general, migrants continue to face the institutional discrimination and are systematically excluded from the public housing programs. Not only low-income housing, but also other welfare programs excluded migrants in the framework of local social policy, which defies the basic principle – social justice – in social policy.

In the internal urban society, there are also inequity problems which arose from the work unit system. In the 1990s, the central government decided to reform the public provision system of housing, and then eventually most public ownership housing converted into private ownership at discounted prices, which benefited those workers in high hierarchy work units. This kind of institutional inequity continued through the 1990s and beyond, and it was exaggerated along with the marketization when the housing prices became much higher in large cities. In a word, the urban poverty and housing inequality problems in China are two related problems, that most of the poor population also being the most disadvantaged people during the housing transition.

Up to today, work units still affect the public housing allocation. For example, some state-owned work units have stronger sources of funding, and have participated in some public housing projects. Taking ECH projects as an example, the work unit has priority access to some land or free administration with self-owned land. After getting the land, the work unit can set up a subordinate real estate company to run the business related to housing. With regard to financing, the work unit can also collect the money from employees for starting a special housing project, which will benefit the employees in the end. Because of the status of state-owned work units having stronger ties with local government, they can get preferential treatment which may not be

transparent. As a result, the employees can buy the housing in the name of public housing, with a price far lower than the market price. This model is welcomed by some employers as well as employees. For some well-off work units, they have the opportunity to step into the real estate industry, which can be a stronger way to accumulate capital (Lan deng, etc., 2009)

#### **4.3. Local governance in public housing provision**

The central-local relationship is the key issue for understanding the governance model with Chinese characteristics. There have been significant literature research on this topic from aspects of fiscal relationships, political appointees, political control and so on. Some scholars take a positive perspective, that the central-local relationship is a quasi-federal relationship, and local competition has become a driving force for economic development; while others argue that the central government's capability has been severely undermined by decentralization. A recent study shows that local government has considerable autonomy in their own policy, and whether local government is consistent with central government depends on whether their interests are consistent or conflicting. As stated above, the interest of local government in housing provision has often conflicted with that of central government, which led to the former's lack of commitment in line with the central government's plans for most public housing programs.

The most important reason for the conflicting goals originated from the tax reform in 1994. The central government hoped to collect more bargaining power when implementing a specific policy, so took back most of the national tax revenue, only leaving less than 50 percent of tax revenue to local government. To be honest, the tax reform is not a complete reform, because the public expenditure burden of the local government is far beyond its financial capability, which pushes local government to find other channels to make up the deficit. At the beginning of the tax reform, the local government could charge various kinds of taxes, such as agricultural taxes. These taxes are called extra-budget income for the local government, and generated serious rural discontent during the 1990s. By 2006, the central government made a landmark reform, Premier Wen Jiabao abolished agricultural taxes, which greatly reduced the burden for rural populations, but also generated another problem of how to compensate for the budget deficit of the local government. The speed of urbanization accelerated rapidly since 2000, creating huge demand in the market for land development. In China, all of the land is governed by the government, and the local government is the de facto owner of the land. Without an effective supervision system, the local government has a stronger incentive to get revenue from land conveyance fees. Some experts compare the local government to a corporation, and the local financial system to a land financial system. The land conveyance fees account for nearly half of the local government's budget since 1996. Considering the land comes at a premium, the local government more closely controls the land regulations, making available land less than the demand each year, keep housing prices at a high level. While the public housing not only needs the cost of inputs, but also may

squeeze out the market share, this is the basic reason why the local government is resisting the public housing program.

During recent years, the relation between central and local government is a quasi-federal relationship, and most of the governance responsibilities are decentralized to local governments. The local government has a great autonomy over how to implement a specific program. Even though the central government may constrain the motivation of local government by earmarked transfers or mandatory orders, the local government still has a great freedom to make adjustments. Given the large variation of development pace in China, it made sense to allow some adjustment to tailor the local needs. However, the shortcomings of this vague expression in regulation will leave room for local government to change the central policies, especially when the policy will bring nothing of benefit for local revenues. Take the public housing program as an example. The central government hoped to solve the housing difficulties of low income households, but it could not set a uniform standard to define this target population, except for pointing to some referential indexes such as household income as the qualifying criteria. The central government allowed the local government to adapt the policy targeting group base on their own economic level. Since the central government didn't match the majority of the fund, it usually gives considerable autonomy for local decision. From the standpoint of local government, the less input the better, that is, the local government doesn't wish to separate the fund or land to make this kind of resource-draining program, and they are more likely to boost the qualifying criteria, leading to less population above the threshold, thereby implicitly reducing their financial responsibilities.

The last factor that contributes to explaining the dissonance between the central and local targets also comes back to economic concerns. Though the government advocated so many ambitious goals on low-income housing provision, such as 100 percent coverage for the needy families in large cities, most were shelved without fanfare in the end. The performance evaluation system for government officials often focuses on the practical achievement, which is economic goals, and no matter how well the other work turns out, economic performance is one of the most significant indexes with veto power. Thus the economic-centered evaluation system further encouraged the local government to focus on the short-term targets, while ignoring the social targets. More importantly, the central government also didn't place low-income housing construction as a priority, and just like an old saying, "Fish begins to stink at the head", the local governments' inaction on the public provision also refers to the central political wind. Furthermore, the term of service of local government officials is usually 3 to 5 years, and economic performance is visible and could be easily measured, so the local government has a strong incentive to develop large projects, which not only bring substantial land conveyance fees but also present the government's record. Meanwhile, the public housing program does not easily demonstrate the political performance in short run, and most importantly, it was not included in the evaluation system for the local government until 2010.

## 5. Conclusion and Discussion

Housing is not a discrete entity. Housing provision is a part of the construction sector; housing investment is a part of overall capital formation; residential property is a part of the real estate sector; housing finance is a part of the financial sector; housing subsidies are a part of social welfare expenditures; and residential development is a part of urban development. They are, no doubt, large parts, but they still are parts of many larger sectors, each with its own bundle of policies, and these policies from different sectors will definitely affect each other. We cannot, therefore, hope to carve out an autonomous housing policy from these disjoint parts of so many different policy areas, so as to distinguish low-income housing subsidy policy from other kinds of policy.

To make matters more complicated, housing policies are often championed in the pursuit of non-housing agendas, further blurring the definition of what constitutes housing policies. For actors in the housing arena, a well-functioning housing sector is, first and foremost, one that meets housing needs in an efficient, equitable, and sustainable manner, while freeing resources and energies to meet a host of other important needs. Beyond that, the housing sector can indeed provide an efficient and effective mechanism for meeting other needs that transcend the basic need for shelter- such as redistributing income, jump-starting a stagnant economy, expanding the financial system, spearheading urban renewal, etc. Indeed, housing does attract different government sectors that further their conflicting agendas, and in many cases, housing sectors may have to compete, from time to time, with other economic and social sectors vying for the same resources.

The housing policy consists of a set of interventions in the housing sector by different government agencies with different targets. As we described, not all of the interventions sustain a well-functioning housing sector. Shlomo Angel defined a principle which renders the intervention ‘enabling,’ that is, “setting boundaries and giving support while relinquishing control.” Enabling is a concept with a rich connotation in social policy. Specifically, Shlomo Angel distinguishes enabling and non-enabling housing policies in five different aspects:

1. *Special cases of government intervention in the economy as a whole;*
2. *System where housing needs are met by markets and governments should oversee markets and correct market failure, versus system where government are directly responsible for meeting housing needs;*
3. *System governed by the rule of law versus governed by decree;*
4. *Pluralist versus centralist systems, allowing multiple vision of coexist rather than advancing a single shared version;*
5. *Consisting of two different sets of government interventions, each single intervention being enabling or non-enabling in itself.*

The enabling paradigm calls for a housing policy environment that oversees and regulates the sector, keeping the government out of the direct supply of housing and thus leaving the actual



production and delivery of housing to the housing market – be it formal, informal, voluntary, or involving the consumers themselves as producers. The appeal of “enabling” housing policy in many European countries can be attributed to the inclusion of broad-based social forces, to the amplified voices of smaller political constituencies in modern societies, and to the general retreat of government from undertaking bold unpopular measures in the face of organized and decentralized local resistance. In this sense, the enabling paradigm takes as given the motives and the power of diverse forces and tries to devise appropriate rules and incentives that prevent any social forces from becoming predatory.

The concept of “enabling” is instructive to the unsuccessful housing policy practice in China. As the review shows, China has achieved great success in its housing sector after 30 years’ reform. However, it still generated serious housing affordability and housing inequity problems. The main reason for the failure of the housing policy can be attributed to three factors, market failure in low-income housing provision as well as government absence in the public responsibility; decentralization of state governance combined with local fiscal difficulties in low-income housing financing; and the old institutional succession and power conversion with Chinese characteristics. It is noteworthy that all of these factors are just the opposite of the enabling housing policy as listed above. Thus how to promote the Chinese housing policy towards an enabling housing environment is an urgent task for the Chinese government.

First, in the past 30 years, the Chinese government abolished the planned economy system, while bringing in a market-oriented system. All of the social institutions are all centered on the market-oriented system; meanwhile, the government takes economic development as the primary priority at the expense of social welfare construction. As we know the market will fail to insure that everyone is housed at a level acceptable to society as a whole. Because of the absence of government, there is a large gap between the low-income housing demand and housing supply in China. Even though the central government launched some low-income housing programs, the ECH and the HPF programs were set up to improve housing affordability for homebuyers. Thus both programs have benefited the rich more than the poor. What’s more, ECH is basically designed for the low-income population, but actually becomes an instrument to stimulate economy after the global financial crisis. As a result, housing prices continue to rise and housing affordability is getting worse in many Chinese cities. In the future, the Chinese government has to make greater efforts to satisfy the escalating housing demand of the poor population, especially the migrants. In a word, the government should set up enabling housing policy regimes, which allows markets to produce and allocate housing, while ensuring that they do so in an efficient and equitable manner, and the function of government is enabling markets to work and protecting them from market failure.

Secondly, local governments play a key role in the formulation and execution of housing policy, but this role is often glossed over or rendered invisible among policy makers, so that most of housing policy is a national concern and national prerogative. From the housing policy practice

in China, the unbalanced relationship between the central government and local government is the key issue in the housing affordability and housing inequity problem. In most countries, central government has the upper hand in both policy decisions and tax powers, and local governments are fundamentally limited to those powers granted them by central governments. The difference between balanced and unbalanced relationships lies in the degree of the local autonomy in decision making. In the Chinese background, the centralization and decentralization are both demonstrated in the relation between central and local government. The existing tax system made local governments take a small share of budgetary revenue but shoulder the majority of the expenditure. In principle, low-income housing is financed by the local government; subsidies from the central government, though large in total number, cover only a tiny fraction of the actual cost of housing development. Fiscal pressures impel the local government to depend on land conveyances to fund many public services. Thus the tax system needs to be reformed to give local government a larger share of budgetary revenue and allow them to have more diversified local revenue sources other than land conveyance fees. The latest experiment with property tax in large cities is a new direction for local government financing, but much more needs to be done to reverse the inertia of local government motivation on land conveyances.

Thirdly, more profound reforms in the land system are needed in the long run. But the land system is intricately intertwined with the whole social institution in China, that is, reform in the land system will have a far-reaching impact, which may break the Hukou system in the end. Under the current system, local municipal governments are the de facto land owners and the sole providers of land in cities. As the exclusive land owners in a specific area, the local government has monopoly power on land expropriation, together with their fiscal demands on land revenue, pushing the housing prices to a high level. What's worse, this not only harms the purchasing power of urban populations, but also invades private land property of farmers. Thus reform in the land system is imperative. On the one side, it must control the monopoly power of local government on land. Some scholars argue that suburban farmers and rural collectives should be allowed to lease their rural land and to develop commercial housing. This will significantly increase the supply of land and affordable housing.

The reform on land also eases the housing poverty problems of migrants. Most migrants maintain two dwellings, one in the city and another in their homeland. This is also due to the collective land system in China, where exchange of collective land isn't permitted. A housing/land rights exchange could be beneficial to both migrants and the urbanization process. However, caution needs to be exercised when housing or land rights exchange are opened, when farmers give up their rights on land and depend on the urban welfare only, slum problems may be generated as in some African countries. The crux of the land reform is based on the Hukou system, which guarantees that the migrants enjoy the same rights to housing and other welfare benefits in cities. This is a very deep reform which may affect the local governance as well as the relationship between local and central government. At present, it may unrealistic to incorporate the most

vulnerable migrants and to encourage local government to provide affordable housing to all migrants.

Fourthly, because of the old centralized institution in the planned economy, the institutional imbalances with regard to the division of central-local, rural-urban, and higher-lower work units, have still remained significant factors in housing provision. The underdevelopment of non-government actors reflects the lack of pluralistic governance in Chinese policy environment. Like Shlomo Angel said, “Enabling society needs a multiplicity of actors in the housing sector, for if there were only one actor there would be no one to enable.” This is the situation in China, with government taking a large responsibility as well as social wealth, then forcing the government to have no choice but to be responsible for meeting housing needs directly. As a result, the central government can’t reform the inequitable off-budget housing subsidies, under-funded local governments can’t be expected to supply enough low-income housing, and work units, as an interest group, may distort the governments’ actions and render them incapable of attending to their essential goals, such as the ECH program. In short, a balance of power needs to be set up in the housing policy, that is, that no one actor has a monopoly on the truth or a divine mandate to act outside the established rules. In a well-functioning housing sector all actors, which include dwellers, builders, lenders, local government and central government must be able to carry out their objectives, and not some at the expense of others.

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# Social Security in Colombia

Miguel Urrutia Montoya<sup>1</sup>

## 1. Social Security Systems in Colombia

The main acts which regulate the social security in Colombia are Act 100 of 1993, Decree 1295 of 1994 and Act 797 of 2003. This system is led, supervised and coordinated by the Government, but public and private companies share its management. The affiliation is mandatory but the election of the entities is free.

The social security system in Colombia has three main subsystems<sup>2</sup>:

### “General Pension System” (GPS)

The GPS is a dual system; it consists of the traditional regime, named the Average Premium with Defined Benefit System, and the new regime known as the Individual Savings System. Both regimes have different requirements and conditions; however, the regime election is free for the members. The GPS provides a retirement pension, a disability pension (common disease) and a survivor’s pension. Additionally, there are some special regimes for workers of certain public enterprises or unions.

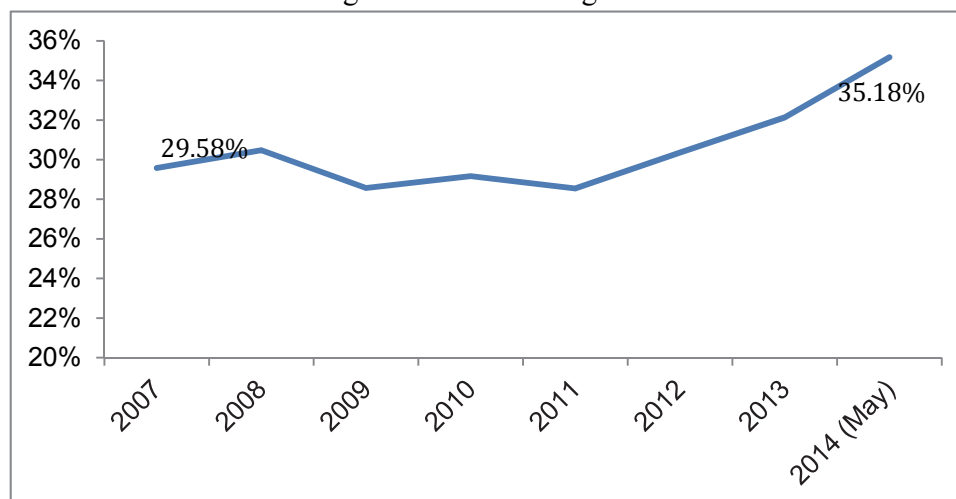
Regardless of the amount of saved money or the number of contributions, there is a minimum pension for everyone within the social security system that ensures a worthy standard of living. By 2014, official statistics show that 35% of the employed population is making contributions in the general pensions system.

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<sup>2</sup> Summary based on Areans Monsalve G. (2012) La estructura normativa del sistema colombiano de seguridad social. In *El derecho de colombiano de la seguridad social* (Chapter 6, p9 159-191), LEGIS.

Figure 1. GPS coverage rate



Source: DANE “Empleo informal y seguridad social”

Table 1. Pension System members from the total number of workers

	2007	2008	2009	2010	2011	2012	2013	2014 (May)
<b>PENSIONS</b>	29,58%	30,48%	28,57%	29,16%	28,54%	30,36%	32,13%	35,18%

Source: DANE, “Empleo informal y seguridad social”<sup>3</sup>

### “General Health system” (GHS)

This system is based on solidarity; there are two regimes, the first one for the people who have the financial capacity to contribute (contributory regime), and the second one for the population in poverty and marginal conditions (subsidized regime). The members of the contributory regime have access to health services, called “Compulsory Health Plan” (POS in Spanish). In addition, members have the option to acquire a Complementary Health Plan by paying an additional amount of money. Also, members of this regime have the opportunity to affiliate their relatives; they are known as contributive regime “beneficiaries”. The members of the subsidized regime have to make a minor contribution; they are beneficiaries from the solidarity scheme. As in pensions, the health system also has special regimes for some public enterprises or unions. The rest of the population – that is, the ones who are neither in the contributory nor the subsidized regime – only have access to health services to the extent of availability of monetary resources.

The official statistics in Colombia for May of 2014 show that 91% of the employed population has access to the health system in any regime. About 49% of workers are in the contributory regime while 39% of them belong to the subsidized regime.

<sup>3</sup> DANE “Empleo informal y seguridad social” data is available at <https://www.dane.gov.co/index.php/mercado-laboral/informalidad-y-seguridad-social>



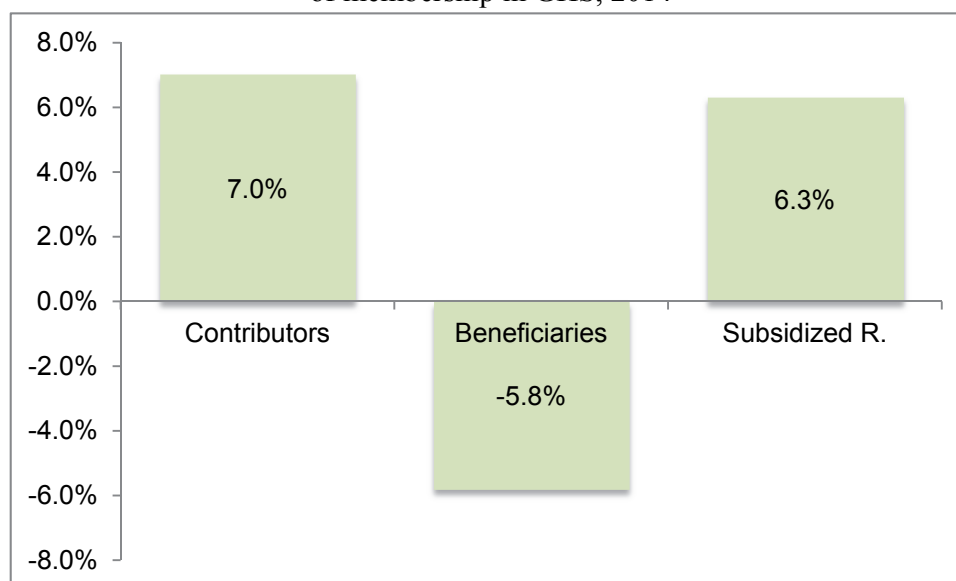
Table 2. Health System members as a percentage of total number of workers by regime

	2007	2008	2009	2010	2011	2012	2013	2014 (May)
<b>HEALTH</b>	84.38%	87.18%	88.50%	88.94%	89.64%	89.90%	91.52%	91.65%
<b>CONTRIBUTORY R.</b>	45.73%	46.03%	44.02%	44.24%	45.05%	45.24%	46.93%	49.70%
<b>SPECIAL R.</b>	2.17%	2.04%	2.18%	2.53%	2.28%	2.53%	2.69%	2.59%
Contributor	37.51%	37.83%	35.50%	36.03%	35.80%	36.86%	38.30%	41.45%
Beneficiary	10.39%	10.20%	10.66%	10.67%	11.32%	10.76%	11.04%	10.52%
Other	0.01%	0.04%	0.04%	0.07%	0.21%	0.16%	0.27%	0.31%
<b>SUBSIDIZED R.</b>	36.45%	39.10%	42.28%	42.15%	42.28%	42.10%	41.83%	39.30%
<b>UNKNOWN</b>	0.04%	0.01%	0.01%	0.02%	0.03%	0.02%	0.07%	0.06%

Source: DANE “Empleo informal y seguridad social”<sup>4</sup>

It is important to remark that the number of people making their proper contributions to the health system have been increasing while the quantity of people in the subsidized regime is also increasing.

Figure 2. Percentage change of employed population according their type of membership in GHS, 2014



Source: DANE “Empleo informal y seguridad social”

### “General system of Occupational Risks Insurance” (GORI)

It is mandatory for all employers to enroll their workers in the GORI system. The amount of the contributions depends on the potential risk that derives from the performance of the employee in a particular job. The GORI provides disability pensions and compensation in the occurrence of workplace accidents and occupational illnesses.

<sup>4</sup> Idem.

Nevertheless, there is a fourth subsystem, which could be called “Complementary Social Services”. It includes for example financial support for indigent elders and an unemployment subsidy.

In summary, social security in Colombia provides the following benefits:

- Medical assistance: Even when health is considered as a fundamental right in Colombia, it is necessary to make a minimum number of contributions to access health services.
- Benefits for common disease: Sick workers have the right to receive compensation for the time during which they were not able to work.
- Benefits for maternity and paternity: It has the same logic of the benefits for common disease, that is to say that the GHS has to cover salaries of parents around the time of the birth of their child, for both men and women. Women are entitled to a period of maternity leave of 14 weeks; the period is 8 days for paternity leave.
- Benefits for work-related accidents and occupational diseases: The insurance covers the payment of compensation for disease or death when the accident or sickness is work-related. It covers medical expenses, disability pensions when the employee is not able to work anymore and survivor’s pensions when the employee dies.
- Retirement benefits: This is the old-age pension. By 2014, to be entitled to receive an old-age pension, the employee must have contributed for 1,275 weeks (by 2015 it will be 1,300 weeks) and must be 57 years old for women and 62 years old for men.

In Colombia, there are three main problems in Social Security: i) low coverage, ii) lack of equity and iii) fiscal unsustainability; nonetheless, that does not mean that the quality of services provided by the system is not a problem.

- Coverage: The improvements in coverage have been minimal. 20 years ago when the system was reformed, the traditional system coverage reached 16% of older adults. By 2012, only one in five older adults was a member of the traditional system. Between both systems, meaning the traditional system and the one created in 1993 (Individual Saving System), the number of beneficiaries of Social Security older than 65 years is close to 44%, which according to the World Bank is one of the lowest coverage rates in the region<sup>5</sup>. As shown before, only 35% of the working population is making the respective contributions for receiving an old-age pension.
- Equity: In terms of equity, some studies suggest that workers at the bottom end of the earnings scale cannot meet the requirements to receive an old-age pension, because their contributions are not sufficient. Therefore, those people are financing the old age pensions of workers with a higher income. Also, there is evidence that the majority of subsidies in

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<sup>5</sup> Portafolio (2014). El sistema de seguridad social tradicional de Colombia se encuentra entre los más débiles de América Latina en cuanto a su cobertura. Available at <http://www.portafolio.co/economia/colombia-es-los-mas-debiles-seguridad-social-bm>

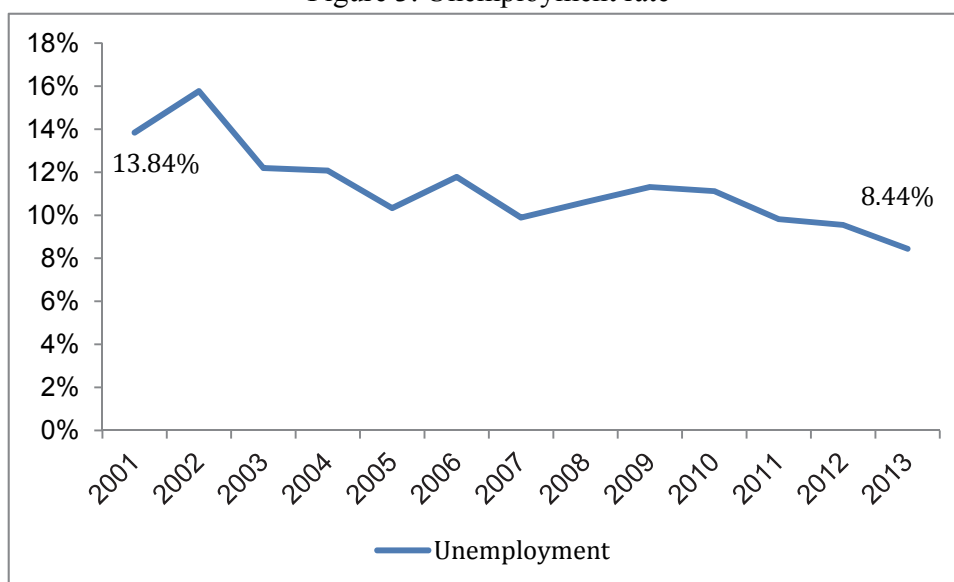
pensions are given to the richest quintile of the population, which is a problem of equity but also a consequence of low coverage rates<sup>6</sup>.

- Fiscal sustainability: According to studies, 42% to 72% of the amount of pensions within the Average Premium with Defined Benefit System are subsidized<sup>7</sup>. On the other hand, the General Pensions System has not evolved in parallel with demofigureic changes. For example, the life expectancy is higher today; therefore, there is an increasing necessity for old age pensions.

## 2. Unemployment and Informal Sector in Colombia

Unemployment and informality are important problems linked with the social security, since only the workers are obliged to join the pension system. With regard to informality, there is a high correlation between the number of formal workers and the number of members in the social security system. The unemployment rate has decreased in the last few years, while on the contrary the informality rate remains high.

Figure 3. Unemployment rate



Source: Banco de la Republica, “Labour Market”<sup>8</sup>

There is not a single definition of ‘informality’; Colombia currently uses the definition given by the *Fifteenth International Conference of Labour Statisticians* of the ILO and recommendations of the Delhi group. Under this perspective, the definition of ‘informal sector’ takes into account the “characteristics of the production units (enterprises) in which the activities take place (enterprise approach)”<sup>9</sup>

<sup>6</sup> FEDESAROLLO (2010). El sistema pensional en Colombia: Retos y alternativas para aumentar la cobertura. P.14. Available at [http://www.fedesarrollo.org.co/wp-content/uploads/2011/08/El-sistema-pensional-en-Colombia\\_Retos-y-alternativas-para-aumentar-la-cobertura-12-de-abril-2011.pdf](http://www.fedesarrollo.org.co/wp-content/uploads/2011/08/El-sistema-pensional-en-Colombia_Retos-y-alternativas-para-aumentar-la-cobertura-12-de-abril-2011.pdf)

<sup>7</sup> Idem. p. 13

<sup>8</sup> Banco de la Republica, “Labour Market” data is available at <http://www.banrep.gov.co/en/taxonomy/term/6353>

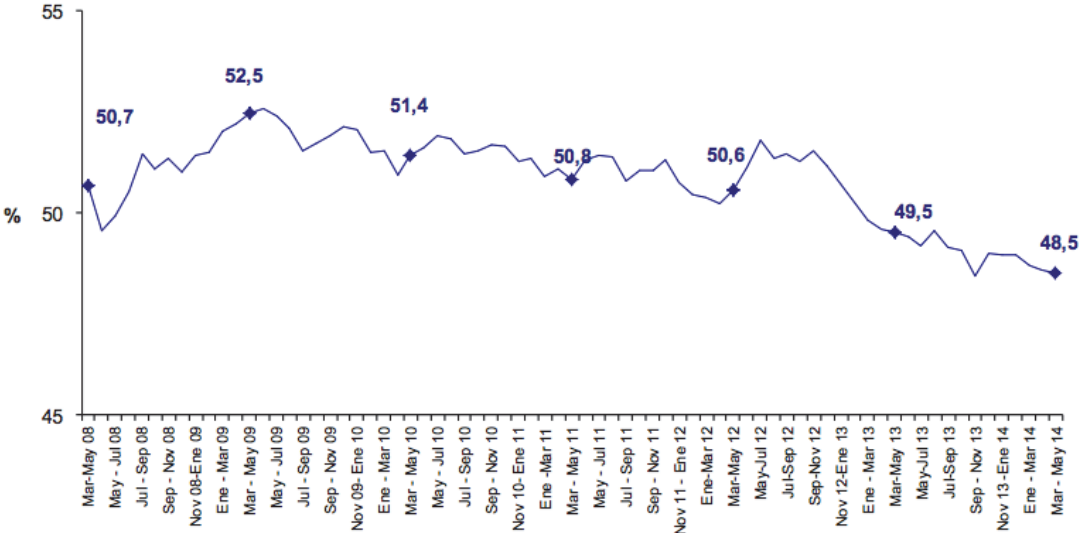
<sup>9</sup> Delhi Group (2004). 7th meeting of the Expert Group on Informal Sector Statistics. Available at <http://ilo.org/public/english/bureau/stat/download/papers/def.pdf>

Specifically, the guideline to determine whether a job is informal or not, is comprised of the following criteria<sup>10</sup>:

1. Employees of enterprises with five or less workers in all their branch offices.
2. Contributing family workers.
3. Nonpaid workers in any enterprise.
4. Domestic workers.
5. Day laborers.
6. Own-account workers, except independent professionals.
7. Employer of enterprises with five or less workers in all their branch offices.

The available data on informality (13 major metropolitan areas) shows that informal employment rates have decreased over the last few years at a slow pace.

Figure 4. Informality rate in 13 major metropolitan areas

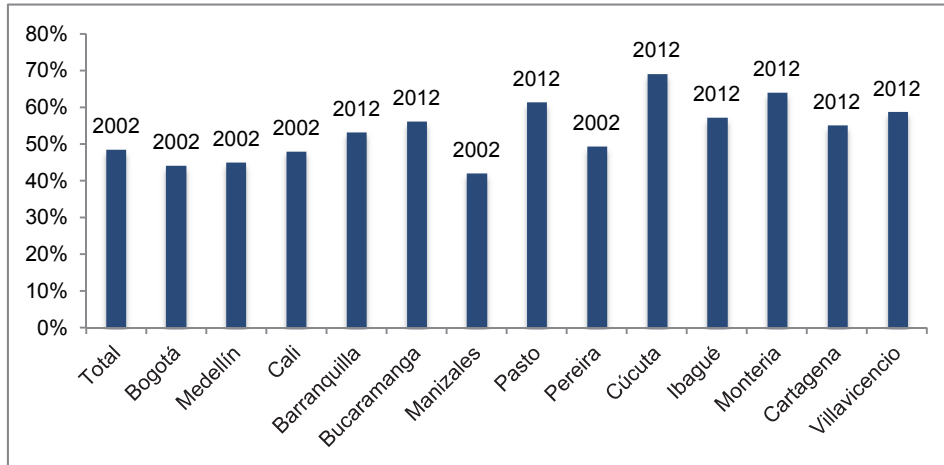


Source: Taken from DANE<sup>11</sup> “Empleo informal y seguridad social”

According to the figure featured above, by May 2014, 48.5% of the population employed in the 13 major cities and its metropolitan areas have an informal job.

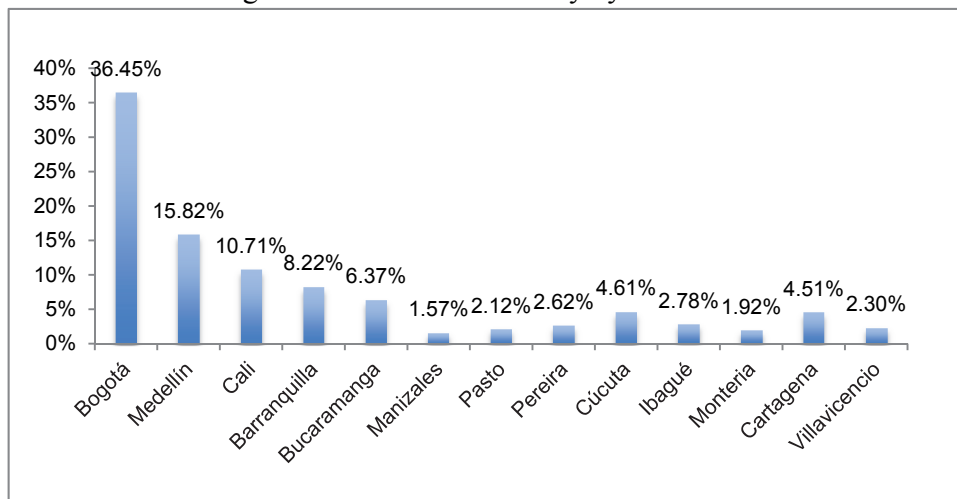
<sup>10</sup> DANE (2009). Metodología informalidad, Gran Encuesta Integrada de Hogares 2009. Available at [https://www.dane.gov.co/files/investigaciones/boletines/ech/ech\\_informalidad/metodologia\\_informalidad.pdf](https://www.dane.gov.co/files/investigaciones/boletines/ech/ech_informalidad/metodologia_informalidad.pdf)  
<sup>11</sup> DANE (2014). Resumen ejecutivo, medición del empleo y seguridad social, trimestre móvil marzo-mayo 2014. Available at [https://www.dane.gov.co/files/investigaciones/boletines/ech/ech\\_informalidad/re\\_ech\\_informalidad\\_mar\\_may2014.pdf](https://www.dane.gov.co/files/investigaciones/boletines/ech/ech_informalidad/re_ech_informalidad_mar_may2014.pdf)

Figure 5. Informality rate by cities 2014



Source: DANE “Empleo informal y seguridad social”

Figure 6. Share of informality by cities 2014

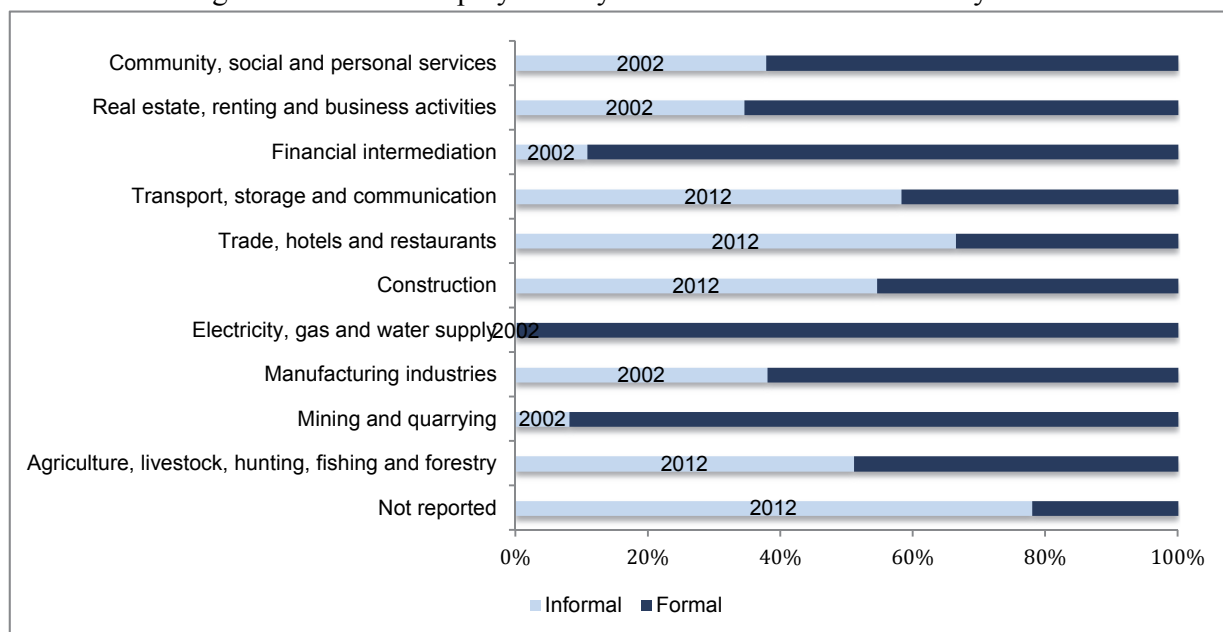


Source: DANE “Empleo informal y seguridad social”

The cities with lowest informality rate are Manizales, Bogotá and Medellín. Nevertheless, half of the informal employees are concentrated in the last two. It is worrisome that in eight of the thirteen major cities, the informality rate is over 50%.

With regard to the branch of economic activity, the highest levels of informality are in trade, hotels and restaurants. Additionally it has to be stressed that informality is almost non-existent in electricity, gas and water supply services.

Figure 7. Informal employment by branches of economic activity 2014

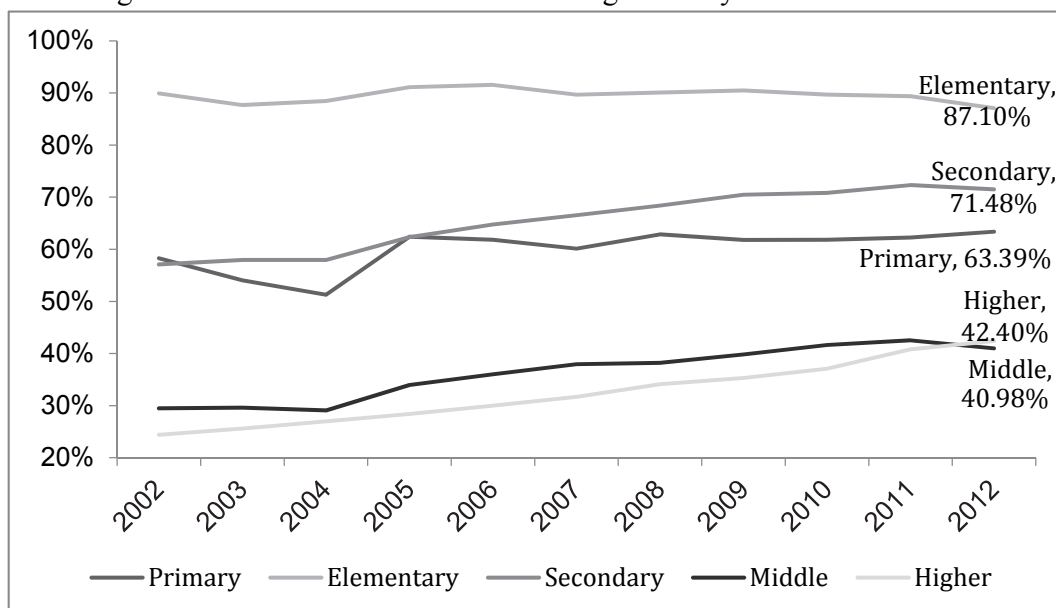


Source: DANE “Empleo informal y seguridad social”

### 3. Education in Colombia

The educational system in Colombia consists of five main levels: primary education (pre-school), elementary education (five years), secondary education (four years), middle or high school (two years) and higher education. In higher education there are three categories: professional (4-5 years), “tecnológica” (2-3 years) and “técnica” (1-2 years). According to the most current data available, the coverage rate has improved for almost every one of the levels mentioned above. The greatest advances were in secondary education and higher education; in a decade they increased from 57% to 71% and from 24% to 42%, respectively.

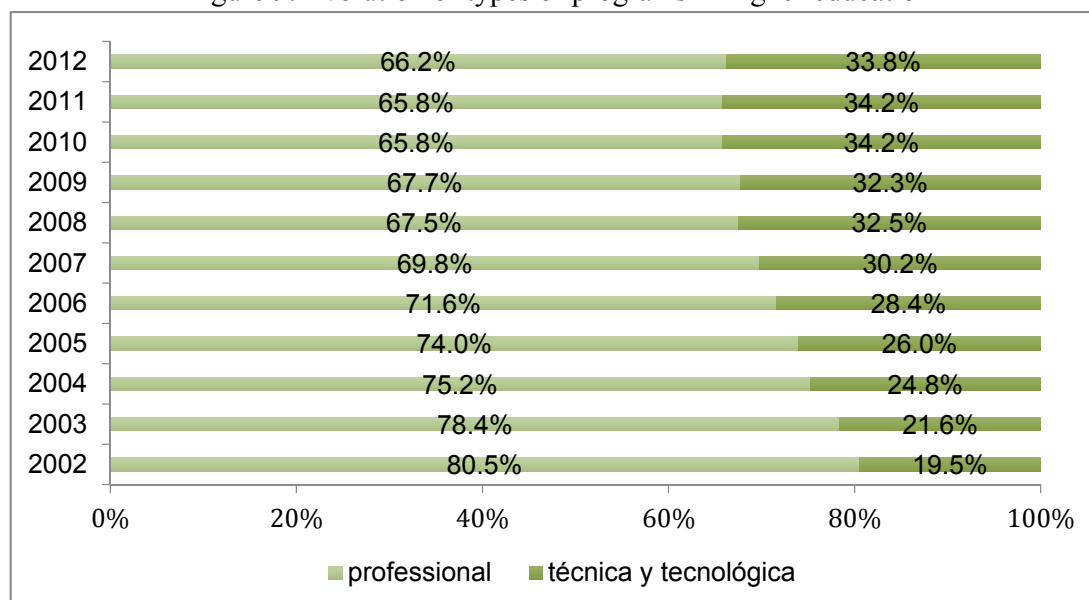
Figure 8. Evolution of educational coverage rates by levels of education.



Source: Ministry of Education<sup>12</sup> “Estadísticas del sector educativo”

Higher education is a particular case in Colombia; the improvements in this level have been caused by the promotion of “técnica” and “tecnológica” education. In fact the number of students in these types of programs increased about 230% in ten years, from 183,319 students in 2002 to 622,746 in 2012. On the other hand, the number of students in the professional programs rose from 754,570 to 1,218,536 during the same period. As a consequence, the share of professional program students in the total of higher education decreased.

Figure 9. Evolution of types of programs in higher education



Source: “La educación superior en Colombia”<sup>13</sup>

<sup>12</sup> Ministry of Education “Estadísticas del sector educativo” available at [http://menweb.mineducacion.gov.co/seguimiento/estadisticas/principal.php?seccion=9&id\\_categoria=2&consulta=gasto\\_por\\_publico\\_nivel&nivel=9&dpto=&et=&mun=&ins=&sede=](http://menweb.mineducacion.gov.co/seguimiento/estadisticas/principal.php?seccion=9&id_categoria=2&consulta=gasto_por_publico_nivel&nivel=9&dpto=&et=&mun=&ins=&sede=)

Despite the progress in coverage, the quality of education has serious problems. For example in the PISA tests (Programme for International Student Assessment) Colombia together with Peru have gotten the worst results in the region, results well below the average of member countries of the OECD<sup>14</sup>. The current debates are about evaluation methods for students and teachers; and increasing resources for research and education. As for the latter, the Colombian government has not committed important resources for education; the table below shows that the public spending as a percentage of GDP has not increased significantly.

Table 3. Public Spending as a percentage of GDP

<b>Year</b>	<b>Elementary, Secondary and Middle</b>	<b>Higher</b>	<b>Not classifiable</b>
2000	3,3	1	0,1
2001	3,4	1	0,1
2002	3,3	1	0,1
2003	3,4	0,9	0,1
2004	3,5	0,9	0,1
2005	3,5	0,9	0,1
2006	3,4	0,9	0,1
2007	3,4	0,9	0,1
2008	3,5	0,9	0,1
2009	3,9	0,9	0,1
2010	3,9	1	0,1
2011	3,8	0,9	0,1
2012	3,8	1	0,1

Source: Ministry of Education “Estadísticas del sector educativo”<sup>15</sup>

<sup>13</sup> Alba L. & Ramos J. (2014). La educación superior en Colombia: situación actual y análisis de eficiencia. Borradores de economía del Banco de la República, Número 808.

<sup>14</sup> ICFES 2012, “Colombia en PISA 2012: Informe nacional de resultados”, document available at <file:///Users/Catalina/Downloads/Resumen%20ejecutivo%20Resultados%20Colombia%20en%20PISA%202012.pdf>

<sup>15</sup> Ministry of Education “Estadísticas del sector educativo” available at [http://menweb.mineducacion.gov.co/seguimiento/estadisticas/principal.php?seccion=9&id\\_categoria=2&consulta=gasto\\_por\\_publico\\_nivel&nivel=9&dpto=&et=&mun=&ins=&sede=](http://menweb.mineducacion.gov.co/seguimiento/estadisticas/principal.php?seccion=9&id_categoria=2&consulta=gasto_por_publico_nivel&nivel=9&dpto=&et=&mun=&ins=&sede=)