



Informality and the expansion of social protection programs: Evidence from Mexico[☆]



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ARTICLE INFO

Article history:

Received 8 August 2012

Received in revised form 29 June 2013

Accepted 15 July 2013

Available online 25 July 2013

JEL classification:

I13

J21

J31

J32

O17

Keywords:

Health insurance

Crowd-out

Development

Job mobility

Wages

ABSTRACT

Many countries are moving from employer-based to universal health coverage, which can generate crowd out. In Mexico, Seguro Popular provides public health coverage to the uninsured. Using the gradual roll-out of the system at the municipality level, we estimate that Seguro Popular had no effect on informality in the overall population. Informality did increase by 1.7% for less educated workers, but the wage gains for workers who switch between the formal and the informal sector were not significantly affected. This suggests that marginal workers do not choose between formal and informal jobs on the basis of health insurance coverage.

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1. Introduction

Universal health coverage has moved to the top of the policy agenda in recent decades. The US has passed the Patient Protection and Affordable Care Act in 2010, which should lead to almost universal health insurance coverage in coming years. Developing countries have also implemented new policies with the goal of moving to universal coverage. These countries include Mexico, Colombia, the Dominican Republic, Ghana, Peru, Tanzania, Thailand, Turkey, and Vietnam (Knaul et al., 2012). Universal

health coverage has therefore been the objective of recent health policy reforms in both developed and developing countries.

A key challenge countries face when moving from employer-based health coverage to universal health coverage is how to finance such an expansion. Universal coverage must be affordable to poorer households. However, by providing affordable government subsidized coverage, governments may increase the take-up of such coverage to the detriment of other more expensive forms of health coverage. Increased take-up of the government subsidized scheme will increase costs to the government and threaten the financial viability of universal health coverage.

In the US context, the impact of the Patient Protection and Affordable Care Act cannot yet be assessed, but researchers have used prior smaller expansions of public health insurance to evaluate whether public health insurance crowds out private health insurance. Most prior research shows that crowd out is likely to be an important issue (e.g. Gruber and Simon, 2008; Pohl, 2012), but there is some disagreement about the exact extent of crowd out, with some researchers finding much smaller effects (Shore-Sheppard, 2008).

This paper focuses on the Mexican drive to provide universal health coverage through the expansion of a publicly provided health scheme. As in many middle income countries, health

[☆] This research was financed by a grant from Centro De Investigacion y Docencia Economicas, A.C. We want to thank Dan Black, Kerwin Charles, Jeff Grogger, Jon Gruber, Jim Heckman, Robert LaLonde, Ken Scheve and Analia Schlosser for helpful comments on previous versions of this draft. We also want to thank seminar participants at the University of Chicago, the 9th Journées Louis-André Gérard-Varet, the 2011 ASSA meetings, the conference “Mind the Gap: From Evidence to Policy Impact” (International Initiative for Impact Evaluation, The National Institute of Public Health of Mexico, The Inter-American Development Bank and The World Bank), and the colloquium “Evidence of a correct public policy: the Seguro Popular” in Mexico City for useful comments.

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insurance in Mexico used to be tied to payroll contributions. More than half of Mexican workers went uncovered because they worked in informal jobs (Perry et al., 2007), i.e. jobs that do not pay mandatory social security contributions. To address this lack of coverage, Mexico introduced a new health benefit system, Seguro Popular (SP), starting in 2002. The program has been expanded since and covers the whole Mexican population as of 2012. SP covers all individuals that are not affiliated with the formal health insurance system based on payroll contributions, and it is in practice free to the overwhelming majority of workers. By providing free health coverage, SP decreases incentives for workers to contribute to the formal health insurance scheme, and is therefore expected to increase informality. We investigate whether Mexico's provision of universal health coverage through SP led to a decrease in the number of workers contributing to the formal health insurance system, and therefore to an increase in informality.

We first show that the level of informality in a municipality prior to the introduction of Seguro Popular does not determine when Seguro Popular is eventually introduced. We then exploit the progressive roll-out of Seguro Popular at the municipality level to analyze the impact of Seguro Popular on informality using panel regressions with municipality fixed effects. Seguro Popular does not significantly increase informality, and this result is robust to several definitions of informality. When using our preferred definition of informality, i.e. having no formal health insurance or being self-employed, the increase is of the order of 1 percentage point and is not significant over the whole employed population. However, if we restrict the sample to workers with less than nine years of schooling, we find that Seguro Popular was associated with a significant 0.9 percentage point increase in informality (60% of workers are informal in this group). Slightly larger significant increases in informality are found when the sample is further restricted to married heads of household with children, or to workers over 34 years old. The heterogeneity in the impact is likely explained by the fact that some workers are more sensitive to the availability of health insurance when deciding to work formally or informally. Additionally, the small size of the effect suggests that marginal workers do not choose between formal and informal jobs based on the availability of health insurance.

If workers who move between the formal and the informal sector value health insurance benefits, one would expect, all other things equal, to see a decrease in the wage differential between the formal and the informal sector after the introduction of SP. We analyze the impact of SP on wage gains for workers moving from the formal to the informal sector, as well as for movers in the opposite direction. We find no significant effect of SP on wage gains for either direction of the move. The absence of an effect on wages is consistent with marginal workers placing little to no value on health benefits.¹

Finally, since *Oportunidades* was introduced in urban areas during the same period as Seguro Popular, and served as one of the channels to recruit participants in Seguro Popular, we examine both programs together. *Oportunidades* is a means-tested conditional cash transfer. As such, the program may incentivize workers to work informally in order to conceal income more easily and pass the means test. We find that *Oportunidades* did not have a significant impact on informality, and controlling for the introduction of *Oportunidades* does not affect the results for SP.

These findings should be reassuring to policy makers: *Seguro Popular* offers workers protection against catastrophic health expenditures without having much impact on the take-up of the

formal health insurance scheme, i.e. with limited to no crowd out. These results make it more likely that *Seguro Popular* is welfare improving. However, to the extent that marginal workers do not seem to value health benefits, health insurance financing through payroll taxation may create labor market distortions. For workers who do not value health insurance, payroll taxes for health benefits are a pure cost. After the introduction of Seguro Popular, this cost remains the same and no new benefits are added since these workers do not value health benefits. Therefore, regardless of the existence of Seguro Popular, workers who do not value health benefits would choose less productive informal jobs over more productive formal jobs so as to avoid paying the cost of health insurance. While our results show that Seguro Popular does not have a significant impact on the take-up of the formal employer-based insurance scheme, they suggest that payroll tax financed health insurance itself may generate labor market distortions through tax avoidance.

This paper makes four key contributions to the existing literature. First, we contribute to the literature on crowd out in developing countries. While Camacho et al. (2009) find evidence of a significant increase in informality after the introduction of a public health scheme in Colombia, our results imply that there is no crowd out generated by SP in Mexico. Indeed, the overall coverage of the payroll financed health insurance scheme did not significantly decline after the introduction of SP. Our second contribution relates to the impact of health insurance on labor mobility (“job lock”) and wages. The US literature² has found mixed results for both of these outcomes, with papers identified off policy experiments generally finding results more supportive of a negative impact of health insurance on labor mobility (Madrian, 1994) and wages (Gruber, 1994). Using a policy experiment which entails a change in the cost of health insurance that is arguably much larger than the changes used in US studies,³ we do not find evidence that extending health insurance coverage increases job mobility or reduces wages of covered workers in the Mexican labor market. We therefore do not find evidence for job lock caused by payroll financed health benefits prior to the introduction of SP.

Our third contribution is to the specific debate on the impact of Seguro Popular on informality (Levy, 2008). Working papers looking at the early years of the introduction of SP (Campos-Vazquez and Knox, 2011; Barros, 2009) failed to find any significant effect of the program. Our time frame allows us to look at medium-run impacts and we show that, while there is indeed a significant increase in informality for less educated workers, the effect is small and does not increase over time. Additionally, our data on the wages of workers who switch between formal and informal jobs allows us to better understand why the effect of SP on informality is so limited. Our results are consistent with workers who are close to indifferent between working formally and informally placing little to no value on health benefits. A recent working paper (Aterido et al., 2011) has reexamined the impact of Seguro Popular on informality using the same data we use here, but focusing on households instead of individuals as the main unit of analysis. The key result of this paper is similar to our own, in that the authors find that Seguro Popular had a very small effect on formality: specifically, they find a 0.4–0.7 percentage point reduction in formality following the introduction of SP. Their results concerning the impact of SP

¹ We also examine alternative explanations for the absence of an impact on wages below.

² The institutional setup in Mexico is quite different from the US one, primarily because health insurance contributions are mandatory in Mexico but optional in the US. We will discuss below how this affects the amount of crowd out and job lock in Mexico relative to the US.

³ Seguro Popular provides essentially free benefits that are close in quality to what is provided by the formal health system, which is financed by a 12.5% tax on wages.

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