

# Contents

<b>Acknowledgments .....</b>	<b>ix</b>
<b>Acronyms and Abbreviations .....</b>	<b>xi</b>
<b>Chapter 1: Opportunity and Risk in a Globalized Latin America and the Caribbean.....</b>	<b>1</b>
Latin America and the Caribbean’s Performance Improved in the 1990s .....	1
Opportunities and Risks.....	1
Why Economic Insecurity? .....	3
This Report .....	6
LAC’s Volatility is High—But has not Risen in the 1990s .....	6
Dealing with Economic Insecurity Requires a Comprehensive Insurance Approach .....	7
LAC’s Volatility Arises from Multiple Sources—Domestic and Foreign .....	7
Governments Can Do Much to Reduce Volatility—Even in a Globalized Economy .....	7
External Risks Can Be Reduced by Diversification and Liquidity Management .....	8
Anticyclical Macroeconomic Policies Ease Adjustment to Shocks .....	8
Deeper and Stronger Financial Systems Are a Key Part of Social Protection Policies.....	8
Deep Crises are Particularly Damaging for the Poor .....	8
The Poor Try to Protect Their Long-Term Welfare in Crises—As Long as Their Assets Permit .....	9
New Income Support Programs for the Unemployed Need to be Established.....	9
Administrative Capacity and Labor Policies are Key in the Choice of Instruments .....	9
Self-Insurance for Slow-Reforming Economies .....	10
Unemployment Insurance for Advanced Reforming Economies .....	10
Public Works Programs Provide Insurance Support for Informal Sector Workers .....	10
Targeted Programs for the Poor Need to be Better Protected in Downturns .....	10
Save in Good Times to Finance Social Spending in Bad Times .....	10
Supranational Action and the Role of the International Financial Institutions .....	11
Myths and Realities About Economic Volatility .....	11
Securing Our Future .....	11
Notes .....	11
<b>Chapter 2: Economic Insecurity in Latin America and the Caribbean: The Stylized Facts.....</b>	<b>13</b>
Methodological Considerations .....	13
Aggregate Volatility in Latin America .....	15
Volatility in Aggregate Output .....	15
Volatility in Aggregate Consumption .....	15
Differences in Volatility Across Countries Within the Region .....	16
Regional Trends in Economic Volatility .....	18
Transmission of Aggregate Volatility to the Labor Market .....	21
Are Latin American Workers Facing More Risk? .....	23
Changes in Earnings Volatility .....	23
Trends in Unemployment Rates .....	24
Changes in Turnover Rates .....	26
Rise in Informality .....	27

The Deterioration in Prospects of Older Workers . . . . .	31
Changes in Income Distribution . . . . .	32
Conclusion . . . . .	32
Notes . . . . .	35
<b>Chapter 3: Designing Social Policy When People Face Risk: A Conceptual Framework . . . . .</b>	<b>37</b>
The Need for Sound Analysis . . . . .	37
Approach and Implications . . . . .	38
Advantages of a Disciplined Approach . . . . .	39
Clearer Rationale for Government Action . . . . .	42
Useful Insights . . . . .	42
A Powerful Tool for Organization . . . . .	43
Conclusion . . . . .	43
Notes . . . . .	44
<b>Chapter 4: Macroeconomic Volatility in Latin America and the Caribbean: Causes and Remedies . . . . .</b>	<b>45</b>
Sources of Aggregate Volatility in LAC . . . . .	45
External Shocks . . . . .	45
Macroeconomic Policy Volatility . . . . .	49
Absorption and Amplification of Shocks: The Importance of Financial Markets . . . . .	50
Weak Links with World Financial Markets . . . . .	52
Shallow Domestic Financial Markets . . . . .	53
The Combination Increases the Likelihood of Economic Crises . . . . .	54
Other Amplification Mechanisms . . . . .	57
Summary . . . . .	61
Policies to Deal with Aggregate Volatility in LAC . . . . .	61
Terms of Trade Risk . . . . .	65
Capital Flows . . . . .	66
The Financial System . . . . .	67
Fiscal Policy . . . . .	67
Monetary and Exchange Rate Policy . . . . .	67
Supranational Action . . . . .	68
Annex 1 . . . . .	68
Notes . . . . .	70
<b>Chapter 5: The Response of LAC Households to Economic Shocks . . . . .</b>	<b>73</b>
The Risk of Unemployment: Who is Most Affected? . . . . .	73
Are the Poor Most Likely to Become Unemployed? . . . . .	73
Are Older, Less-Educated Men More Likely to Become Unemployed? . . . . .	73
Is There No Unemployment in the Informal Sector? . . . . .	74
Who Becomes Unemployed and for How Long? . . . . .	76
Household Responses to Income Shocks: Findings of Panel Studies . . . . .	76
Do Aggregate Shocks Hurt the Poor More than the Rich? . . . . .	78
Does Ownership of Assets Reduce Vulnerability to Aggregate Shocks? . . . . .	79
Do the Poor Engage in Self-Destructive or Myopic Coping? . . . . .	81
Are All Downturns the Same in their Effects? . . . . .	83
Conclusion . . . . .	85
Notes . . . . .	86
<b>Chapter 6: Helping Workers Deal with the Risk of Unemployment . . . . .</b>	<b>89</b>
A Typology of Programs . . . . .	90
Main Findings . . . . .	92
Who Is Covered by these Programs? . . . . .	95
How Much Do the Programs Cost? . . . . .	96
What Are the Efficiency Effects and Insurance Benefits? . . . . .	97
What Are the Main Weaknesses of these Programs? . . . . .	98
Policy Implications . . . . .	98
Self-Protection: The State of Labor Markets . . . . .	99
Self-Insurance: Individual Savings Accounts . . . . .	99

"Market-Type" Insurance: Risk-Pooling Programs . . . . .	101
Severance Pay Provisions as Insurance for Unemployment . . . . .	102
Public Works Programs as Insurance for Unemployment . . . . .	102
"Conventional" Unemployment Insurance . . . . .	103
Conclusion . . . . .	107
Notes . . . . .	108
<b>Chapter 7: Helping Poor Households Deal Better with Economic Crises . . . . .</b>	<b>111</b>
Social Spending Over Economic Cycles . . . . .	113
How Do Governments Vary Spending Over the Economic Cycle? . . . . .	113
The Importance of Political Factors . . . . .	114
The Quality of Social Services Over the Cycle . . . . .	116
Targeted Spending During Booms and Busts . . . . .	119
Designing Economic Policy Under Political Constraints . . . . .	121
The Long-Term Goal of Social Policy Must be to Improve the Distribution of Assets . . . . .	122
Targeted Programs Should be Permanent and Better Protected During Crises . . . . .	122
Keeping Increases in Social Spending Moderate in Good Times is Important Too . . . . .	122
International Financial Institutions Can Help Overcome Political Constraints to Insurance . . . . .	122
Conclusion . . . . .	123
Notes . . . . .	125
<b>Bibliography . . . . .</b>	<b>127</b>
<b>Boxes</b>	
Box 2.1 Defining and Measuring Insecurity . . . . .	14
Box 2.2 Trends in Aggregate Volatility in Latin America and the Caribbean . . . . .	20
Box 2.3 Why Might Workers Prefer to be Precarious or Unprotected? . . . . .	31
Box 2.4 Income Mobility and Risk in Two Countries . . . . .	34
Box 3.1 Market Insurance, Self-Insurance, and Self-Protection: Distinguishing Features and Examples . . . . .	39
Box 3.2 A Theory of Comprehensive Insurance . . . . .	40
Box 3.3 The Framework in "Real Life" Situations . . . . .	41
Box 4.1 Excess Sensitivity to Disturbances: The Case of Chile . . . . .	52
Box 4.2 Weak Financial Markets and Volatility: A Framework . . . . .	59
Box 4.3 The Welfare Cost of Volatility and the Gains from International Risk-Sharing . . . . .	62
Box 5.1 Informal Self-Employment: Precarious Workers or Voluntary Entrepreneurs? . . . . .	75
Box 5.2 Data Sets and Methodologies Used . . . . .	77
Box 5.3 Where Does Time Go During a Crisis? . . . . .	83
Box 5.4 Do Families Mortgage Their Children's Future? Other Evidence . . . . .	86
Box 6.1 Income Support Programs for the Unemployed: Main Features . . . . .	91
Box 6.2 Data Sources and Methodology . . . . .	94
Box 6.3 Labor Markets: Latin America's "Forgotten Reform" . . . . .	100
Box 6.4 Combining Mandated Self-Insurance and Market-Type Unemployment Insurance . . . . .	102
Box 6.5 Who Really Pays for Unemployment Insurance? . . . . .	105
Box 6.6 Some Guidelines for Countries that Have Unemployment Systems . . . . .	107
Box 7.1 How Do Pro-Poor Governments Vary Spending Over the Economic Cycle? . . . . .	114
Box 7.2 Data Sources and Classification into Targeted and Social Spending . . . . .	115
Box 7.3 Social Spending Over Economic and Political Cycles in Latin America . . . . .	116
Box 7.4 Colombia's Healthcare Reform . . . . .	118
Box 7.5 Mexico's <i>Progresa</i> Program: Works Well, But Would it Do as Well in Crises? . . . . .	120
Box 7.6 Social Programs, Entitlements, and Countercyclical in the U.S. . . . . .	124
<b>Tables</b>	
Table 1.1 Per Capita GDP Growth in Latin America (Percent) . . . . .	2
Table 1.2 Per Capita Private Consumption Growth in Latin America (Percent) . . . . .	3
Table 1.3 Survey Responses in Latin American Countries on Expected Changes in Living Standards (Percentages Unless Otherwise Noted) . . . . .	4
Table 1.4 Survey Responses to Social Insurance-Related Questions in 14 Latin American Countries, by Socioeconomic Category (Percentages Unless Otherwise Noted) . . . . .	4
Table 1.5 Economic Insecurity: Twelve Myths . . . . .	12