



Making Labor Markets Work

Improving Productivity and Workers' Welfare
in Latin America and the Caribbean

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David S. Kaplan
Auri Minaya
María Teresa Silva-Porto



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Preface

Labor markets sit at the intersection of well-being, equity, and productivity. They are where development becomes tangible in people's daily lives. Jobs are more than a source of income. They help people build skills, manage risks, and find purpose. Properly functioning labor markets are, in the end, a measure of how well development itself is working.

Over the past three decades, Latin America and the Caribbean has seen the rise of a more educated and larger workforce. Female labor force participation is at the highest level ever. Several countries have advanced in providing more formal employment.

At the same time, the forces that once worked in the region's favor are fading. The commodity boom in the early part of this century has passed. Rapid aging is shrinking the working-age population. Artificial intelligence and other technologies will reshape the demand for work faster than institutions have adapted. Good policies will now have to do what good fortune and favorable demographics once did.

Recent progress has been too modest. We need to scale up our ambitions. We need to be much better prepared for the many changes that are coming fast, including the new technologies and digital tools.

Today, large swathes of the labor market in the region are often dominated by small, low-productivity firms and excessively high rates of self-employment. As a result, productivity remains very low: it takes nearly four workers to produce what one worker can do in the United States. But low productivity is not the only problem. Workers receive only about half of the revenue they generate, compared with more than four-fifths in advanced economies. At the same time, labor income inequality between workers is also high, even among workers with similar levels of education and experience.

This diagnosis points to the book's central message: labor market reform is not a narrow technical exercise. It goes to the heart of the region's productivity, its inequality, and the strength of its social contract.

A key insight of this book is that productivity and worker welfare need not be opposing objectives. With the right mix of policies, countries can improve both. Too often, however, debates about labor reform become trapped in a false "pro-business" versus "pro-worker" dichotomy. The authors argue forcefully the region would benefit from a paradigm shift.

Preface

A smart mix of policies—be it in fomenting more competition for labor or adjusting minimum wages—can lead to productivity improvements as well as better working conditions. The book provides a hands-on approach for policymakers to understand the trade-offs and look out for policies that might improve worker welfare on paper but be counterproductive in practice. It identifies policies that can reduce inequality and strengthen social protection in ways that are consistent with and often reinforce the productivity agenda.

As new forms of work are emerging, regulatory frameworks will need to adapt accordingly. The urgency is growing because exposure to artificial intelligence is expected to increase substantially, from about 5 percent of jobs being highly exposed in the short term to more than one-third over a ten-year horizon. When regulations make the cost of our formal labor high relative to the cost of capital, firms then have an incentive to accelerate automation not necessarily in response to productivity gains, but because of relative price distortions. Poorly regulated labor markets will make us more vulnerable to the disruptive aspects of technological change.

The book is a mirror and a compass. As a mirror, the authors offer a candid diagnosis of why decades of effort have yielded only modest gains. As a compass, it charts a path forward, organized around a set of principles and recommendations. Crucially, it distinguishes between the structural reforms that are necessary but also require broad political consensus and the gradual, implementation-focused improvements that can be undertaken at lower political cost. This distinction matters: it shows that transformational progress need not wait for a single grand bargain. It can be built, step by step, through reforms that are already within reach.

Making Labor Markets Work draws on three decades of comparable data, multiple country diagnostics, and years of the Bank's policy engagement across the region. It builds on recommendations of earlier work. The Bank's distinctive perspective comes from working alongside governments, observing reforms in practice, and learning across countries.

That perspective has also been built through decades of operational engagement, from supporting labor and pension reforms to helping governments across the region modernize social protection systems, expand social registries, strengthen digital delivery mechanisms, and improve job opportunities for vulnerable workers. We have helped Barbados, Chile, Mexico, and Panama advance pension reforms. We have worked with Mexico to improve its regulatory environment. We have worked with Bolivia, Colombia, Peru, and Paraguay to improve their active labor market programs. We have worked with Colombia, Jamaica, and Suriname on skills development. We are working with Costa Rica and Mexico to improve their care economies, potentially benefiting female labor supply. And each operation teaches us how to make the next one better.



Preface

This publication is not only an analytical contribution. It presents a comprehensive blueprint for reform—pairing bold structural changes with pragmatic actions that can begin today. It is an invitation to action by governments, social partners, and institutions that shape the world of work. Our colleagues across the IDB Group will be there to support them on this journey. Our aspiration is that the region's labor markets will better translate talent into opportunity, productivity into prosperity, and economic growth into dignity.

Ana María Ibáñez

Vice President for Sectors and Knowledge
Inter-American Development Bank

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Notwithstanding the valuable contributions of the many people who provided inputs to this volume, any errors or omissions are entirely the responsibility of the authors and do not necessarily reflect the views of the IDB, its Board of Directors, or the countries they represent.

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Abbreviations and Acronyms

AI	Artificial intelligence
ALMP	Active labor market policy (also active labor market <i>programs</i>)
EPL	Employment protection legislation
EPR	Employment protection for regular (permanent) contracts
EPT	Employment protection for temporary contracts
FWA	Flexible work arrangement
GDP	Gross domestic product
HR	Human resources
IDB	Inter-American Development Bank
ILO	International Labour Organization
ISSA	International Social Security Association
LAC	Latin America and the Caribbean
LLM	Large language model
NQF	National qualifications framework
OECD	Organisation for Economic Co-operation and Development
OSH	Occupational safety and health
PES	Public employment services
PPP	Purchasing power parity
RBF	Results-based financing
SIB	Social impact bond
SME	Small and medium-sized enterprise
TFP	Total factor productivity
TVET	Technical and vocational education and training
WBL	Work-based learning

Country Codes

Some figures and boxes in this publication use the following three-letter codes (ISO 3166-1 alpha-3) for countries in Latin America and the Caribbean.¹ Comparator countries outside the region are identified by their full names.

ARG – Argentina	DOM – Dominican Republic	PAN – Panama
BHS – The Bahamas	ECU – Ecuador	PER – Peru
BLZ – Belize	GTM – Guatemala	PRY – Paraguay
BOL – Bolivia	GUY – Guyana	SLV – El Salvador
BRA – Brazil	HND – Honduras	SUR – Suriname
BRB – Barbados	HTI – Haiti	TTO – Trinidad and Tobago
CHL – Chile	JAM – Jamaica	URY – Uruguay
COL – Colombia	LCA – Saint Lucia	VEN – Venezuela
CRI – Costa Rica	MEX – Mexico	

1. Figures and tables frequently report regional aggregates in the form LAC-n (for example, LAC-13, LAC-16, or LAC-17), where n indicates the number of countries in the region included in the calculation. Because the underlying household surveys and administrative data are not available for every country in every year, the composition of these aggregates varies by indicator and period: each aggregate reflects the set of LAC countries with comparable data for the measure shown. Unless otherwise indicated, LAC-n values are unweighted averages of the countries included.



1

Introduction: The Case for Transforming Labor Markets



This book argues that making labor markets work—for both productivity and workers' welfare—is among the most important and most neglected levers available to Latin America and the Caribbean. It offers a comprehensive diagnostic of how labor market conditions in the region have evolved over the past three decades; a cross-country comparison of the policies that govern salaried employment, protect workers against shocks, and develop their skills; and an assessment of what thirty years of evidence tells us about which of these policies have worked, which have not, and why. Drawing on this analysis, the book sets out a reform agenda that combines structural change with gradual, implementation-focused improvements. The agenda is ambitious. It is also, we argue, both feasible and overdue.

In making this case, the book builds on two important predecessors. More than two decades ago, *Good Jobs Wanted*, an IDB report on labor markets in Latin America and the Caribbean, was published during a period of high unemployment in the region (Cowan et al. 2004). A decade later, *Jobs for Growth*, another IDB publication, highlighted the role of labor market policies in enhancing labor productivity (Alaimo et al. 2015). Since the publication of both reports, the region has undergone major economic shifts. In the early twenty-first century, it experienced significant economic growth driven largely by a surge in global demand for commodities. This favorable phase ended in the mid-2010s, followed by a period of stagnation and, more recently, a deep recession caused by the pandemic, from which the region has since recovered strongly. Despite these cycles, most countries in the region have maintained a degree of macroeconomic stability, a notable contrast to the challenges faced in the late twentieth century.

Social and demographic transformations have substantially reshaped the labor force. As shown in the book, human capital accumulation has advanced, resulting in a labor force with the highest level of educational attainment in the region's history and the highest female labor force participation to date. At the same time, the region is aging faster than anywhere else in the world: the share of older adults is projected to rise from 9 to 15 percent over the next decade, a remarkably rapid shift by historical standards (Aranco et al. 2022).

Making labor markets work—for both productivity and workers' welfare—is among the most important and most neglected levers available to Latin America and the Caribbean.

Some improvements in labor market outcomes have been observed. As noted in the next chapter, average rates of labor underutilization have declined, and several indicators of job quality have improved. In terms of formality, some countries have recorded particularly strong gains. In Brazil, Colombia, Costa Rica, and Uruguay, these gains have been especially substantial, with increases in formality ranging from 12 percentage points in Costa Rica to 18 percentage points in Uruguay, driven by greater formalization of wage employment as well as significant increases in formality among independent workers.

Persistently low productivity underlies the modest improvements observed in labor market outcomes.

However, when viewed in aggregate, the pace of progress has been modest. The share of workers contributing to social security increased from 38 percent in 2004 to 46 percent in 2024. At that rate, it would take more than eighty years for the average country to reach formality levels comparable to those of Uruguay, the region's top performer. Moreover, the region is not catching up with advanced economies; if anything, it is falling further behind. Real labor income per worker rose by about 18 percent over the past thirty years, well below the roughly 30 percent increase observed in countries of the Organisation for Economic Co-operation and Development (OECD).

Persistently low productivity underlies the modest improvements observed in labor market outcomes. As discussed in Chapter 2, total factor productivity (TFP) in Latin America and the Caribbean has remained largely stagnant for decades, contributing little to GDP growth, which has instead been driven mainly by increases in schooling and labor supply. This disappointing productivity performance is closely linked to a labor market structure dominated by small, low-productivity firms: self-employment and very small firms account for an unusually large share of employment by global standards, and this composition has changed little over time.

In this context, labor market institutions have shown more continuity than change. As discussed throughout the book, the core institutional protections established in the mid-twentieth century have largely been maintained. Some countries have adjusted important policy parameters—for example, many have significantly increased the real value of minimum wages and social security contributions—but the core principles of the regulatory framework have remained largely intact. Social security systems continue to focus primarily on formal salaried workers, with a financing model that still rests on payroll contributions that, in many countries, now exceed 50 percent of formal wages and are projected to rise

further with ongoing pension reforms. Severance payments remain enshrined in legislation, often constitutionally, and unemployment insurance is rare and typically provides limited coverage. Collective bargaining continues to reach only a small share of workers in most countries and, with few exceptions, government capacity to enforce labor regulations and social security obligations remains weak, leaving a substantial gap between the rights and protections established in law and those effectively enjoyed in practice. At the same time, noncontributory programs have expanded social protection for informal workers and represent an important institutional innovation of the past two decades. Yet they remain only weakly tied to contributory systems, reinforcing a fragmented architecture of social protection. To support workers at the margins of the labor market, most countries have also expanded investments in employment services and workforce training. These programs, however, are often disjointed, uneven in quality, and weakly linked to long-term economic development strategies, which limits their effectiveness in fostering good employment opportunities.

This stability in the institutional landscape has not been due to legislative inaction. For example, over the past three decades, Colombia has implemented, on average, a reform affecting labor or social security legislation every four months (Álvarez and Villaveces 2021). Yet, despite this intense activity, most changes have been incremental rather than structural, leaving the core architecture of the system essentially unchanged. Comparisons of structural and liberalization reforms across policy areas between the mid-1980s and late 2000s show that labor has consistently been the area with the least reform (Lora 2012b), reflecting the high political costs of altering labor-related entitlements and redistributing labor income in ways that affect well-organized and influential groups. Reforms have often followed cycles of oscillation, with periods of stricter regulation followed by pushes for flexibility, which in turn trigger demands for stronger protections (Lora 2012b; Lora and Olivera 2004; Ribe, Robalino, and Walker 2012).

These patterns help explain why labor regulations in the region exhibit strong path dependence. Many countries in Latin America introduced severance pay, minimum wages, and job security regulations in the mid-twentieth century as part of industrialization strategies, while similar measures appeared later in Caribbean countries. Social security systems and public training institutions were built around formal wage employment and financed mainly through payroll contributions, simultaneously insuring workers against income and employment shocks and supporting skill formation. Subsequent reforms, constrained by political and institutional realities, layered new instruments onto these original structures rather than replacing them. The result is a fragmented, often incoherent policy architecture that overprotects some workers while leaving others with minimal coverage, further compounded by complex regulations and weak enforcement, ultimately leading to the numerous challenges documented in Chapter 2.

Building on these regulatory legacies, the region faces important emerging trends. Among them, demographic change stands out. Annual labor force growth is projected to decline from around 1.25 percent in 2020–2025 to below 0.45 percent by the late 2040s, reflecting the entry of progressively smaller cohorts into the labor market. This shift has significant macroeconomic implications. Labor force expansion has accounted for roughly half of the region's GDP growth over the past five decades, meaning that a key engine of growth is set to weaken substantially. As a result, even the modest gains in per capita income observed over the past three decades will be difficult to sustain without stronger productivity growth.

Technological change is another pressing trend. As discussed in the next chapter, the adoption of new forms of work, such as telework and platform-based employment, remains relatively limited in the region. However, the evidence on emerging technologies—most notably artificial intelligence (AI)—suggests a far more uncertain picture than either technological optimism or alarmism would imply. While early evidence indicates that automation is already affecting jobs that rely heavily on routine tasks, considerable uncertainty remains regarding its broader labor market effects. AI may automate specific tasks and displace some workers, but it also has the potential to augment human capabilities, raise productivity, and generate entirely new tasks, occupations, and industries. Which of these effects ultimately predominates will depend not only on technological developments and the pace of adoption, but also on public policy. Investments in human capital, lifelong learning, and workforce adaptation can help steer AI toward complementing rather than replacing labor. As a result, the trajectory of AI's impact on jobs will depend not only on technological progress but also on the choice of labor market policies that promote continuous skills development, alongside social protection systems that support workers' transitions across occupations affected by technological disruption.

Considering these factors and the inherent difficulties of reform, this book presents not only a comprehensive diagnostic of the challenges facing labor markets in Latin America and the Caribbean, but also an equally comprehensive road map for change: an agenda that combines structural reforms with gradual governance improvements that carry lower political costs. Some recommendations from previous IDB publications remain highly relevant and are reiterated, given that progress in many areas has been limited. At the same time, many recommendations have been updated and expanded to incorporate a decade of new evidence and theoretical insights, lessons from countries that have implemented successful reforms, and emerging trends such as technological change and demographic shifts.

1.1 Why Labor Markets?

Why focus on labor markets? Because economic growth and workers' welfare both depend, fundamentally, on how labor markets function. While many other factors shape these outcomes—such as macroeconomic policy, taxation, public investment, and the education system—the labor market is where these forces meet the lives of workers and the operations of firms. There are two reasons why this matters.

First, the functioning of labor markets determines how much of a country's labor is actually used and how productively it is allocated. When barriers keep people out of the labor force—as happens, for instance, with women in many countries of the region—the economy leaves output on the table. When workers are concentrated in unproductive firms, when productive firms face regulatory obstacles to hiring, or when policies distort workers' occupational choices, the result is the same: a smaller economic pie. As this book documents, these inefficiencies are pervasive in Latin America and the Caribbean.

Second, labor markets determine how that pie is divided. Jobs are the primary source of household income for almost everyone in the region, which makes them the most important channel for reducing poverty and inequality. They are also the channel through which most people are—or are not—protected against the risks of unemployment, illness, disability, and old age. Well-functioning labor markets do more than raise incomes: they reduce vulnerability, stabilize livelihoods, and strengthen people's sense of security and agency.

These two channels are often not in conflict. In many of the policy areas covered in this book, well-designed reforms advance productivity and workers' welfare simultaneously. We should not resign ourselves to having to choose between improving productivity and improving working conditions. Genuine trade-offs exist, but they are narrower than public debate often suggests, and we identify them clearly when they arise.

The challenge for Latin America and the Caribbean is that the region has underperformed on both dimensions: it has struggled to generate sustained productivity growth, limiting the size of the economic pie, while also falling short in ensuring that the gains that are generated translate into broadly shared improvements in workers' living standards. Understanding these twin failures is the starting point for grasping the role of labor markets in the region's development.

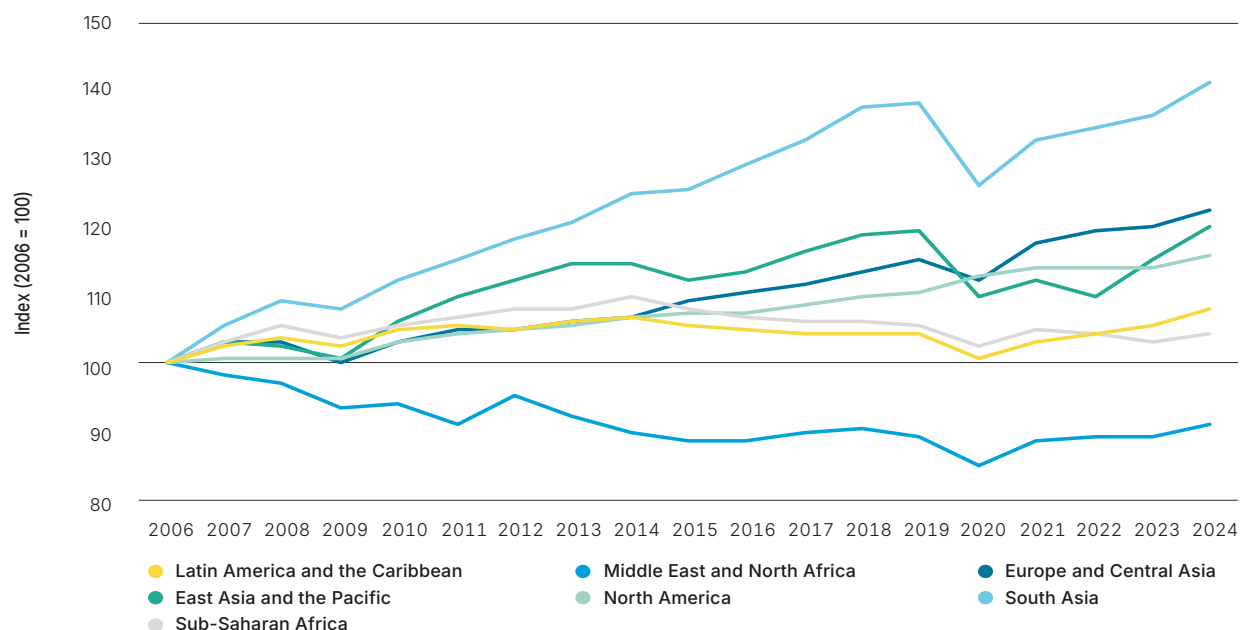
1.2 The Region's Core Failure: Weak Productivity, Unequal Distribution

It takes nearly four workers in the region to produce what a single worker in the United States produces.

Labor productivity, which measures the average output produced per worker, has stagnated for decades. As shown in Figure 1.1, which uses the common measure of GDP per worker, productivity growth over the past two decades has been very slow, lagging behind much of the rest of the world and widening the productivity gap with more developed regions. Relative labor productivity compared with the United States is about 26 percent (The Conference Board 2025), meaning it takes nearly four workers in the region to produce what one US worker produces. This is concerning because sustained

productivity growth is a precondition for generating good-quality jobs. It also presents a major challenge for the future: with labor force growth slowing due to population aging, raising the productivity of the existing workforce will become increasingly critical for accelerating economic growth and improving living standards in the region.

FIGURE 1.1 EVOLUTION OF GDP PER WORKER



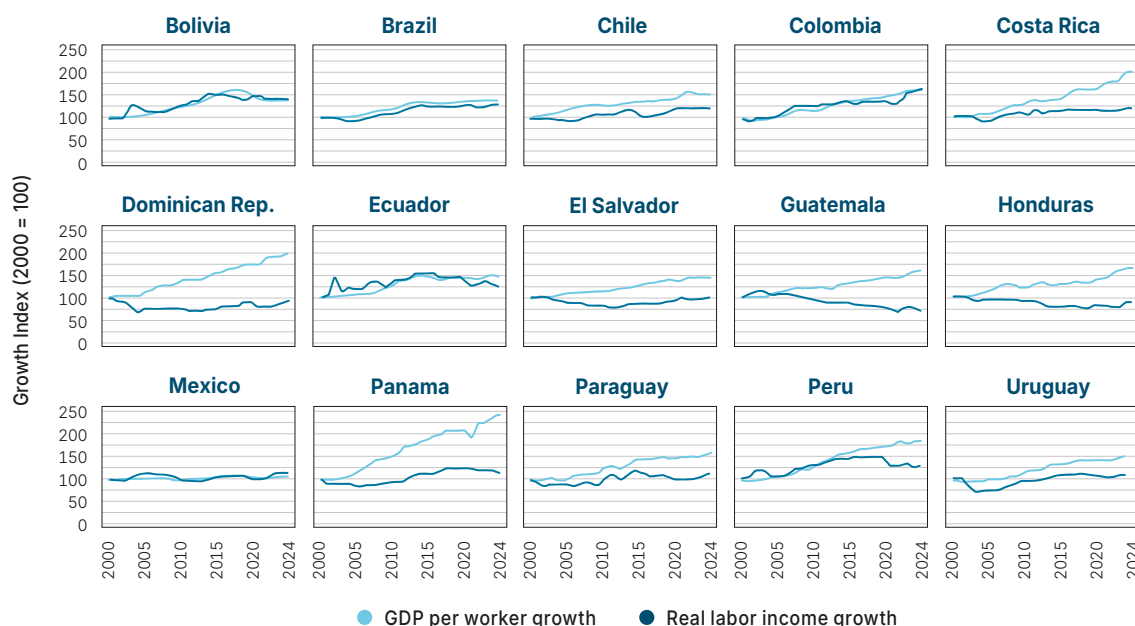
Source: Authors' elaboration, based on data from World Development Indicators (WDI).

Workers' welfare, however, depends not only on productivity but also on how its gains are shared. Figure 1.2 highlights notable differences across countries in the evolution of real labor income, a key measure of workers' welfare that reflects workers' earnings and purchasing power. While real labor income has increased in countries such as Colombia, Peru, and Panama, it has declined in Honduras and Guatemala.

The figure also points to an important observation: labor productivity is a necessary condition for improving workers' earnings, but it is not sufficient. Increases in productivity per worker have not automatically translated into higher earnings for workers. While productivity and labor income rose together in Bolivia and Brazil, labor income increased only slightly in the Dominican Republic and Panama despite major gains in GDP per worker. This finding is key and highlights a fundamental notion: living standards improve only if productivity gains are distributed to workers through better wages.

Productivity gains raise living standards only when they reach workers through better wages.

FIGURE 1.2 EVOLUTION OF GDP PER WORKER AND REAL LABOR INCOME ACROSS COUNTRIES, 2000–2024



Source: Authors' elaboration, based on data from World Development Indicators (WDI) and IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Large inequities in labor market outcomes also remain a major challenge. As shown in Chapter 2, women have substantially lower labor force participation and higher unemployment rates, while ethnic minorities face much higher levels of informality. These gaps persist even after controlling for education and experience. Moreover, as discussed in Chapter 3, limited competition in labor markets means that workers capture only about half of the value they generate—reflecting much larger wage markdowns than those observed in advanced economies. These failures not only exacerbate inequality but also constrain growth: if labor markets in the region were as competitive as those in advanced economies, labor income inequality would decline by roughly 30 percent, GDP per capita would be about 25 percent higher, and average wages would be about 54 percent higher (Alviarez et al. 2025).

1.3 Better Outcomes Require Better Labor Policies and a Better Narrative

A meaningful change of course is needed—but achieving it will require decisive action and, in some cases, a clear break from policy frameworks inherited from the past century. As this book emphasizes, sustained improvements in productivity and workers' welfare depend on a broad set of policies that support firm growth, including access to finance, investments in infrastructure and education, and tax and regulatory frameworks that encourage innovation and expansion. Yet these policies alone are not sufficient. Labor markets are characterized by pervasive frictions and market failures that hinder the efficient allocation of workers and jobs, weaken incentives for skills acquisition, limit labor mobility, and reduce firms' capacity to grow and innovate. Labor policies are therefore not merely complementary to a productivity agenda; they are an essential component of it. Without well-functioning labor market institutions and policies, productivity gains will remain elusive and improvements in workers' living standards will be limited. For this reason, labor policies must occupy a central place in any long-term strategy to raise productivity and expand economic opportunity.

Equally important is reconsidering the narrative around labor policy and moving away from oversimplifications and false dichotomies. Debates in labor policy are often framed around a supposed conflict between “pro-worker” and “pro-business” reforms. While some policies may emphasize growth and others income distribution, the distinction is not nearly as stark as often portrayed. Policies typically classified as pro-business can, when well designed, substantially benefit workers. For instance, reducing hiring costs can increase employment and wages and may even lead firms to compete more to attract and retain workers. Similarly, measures traditionally considered pro-worker, such as minimum wage increases, can also

support economic growth. If properly designed and set at an appropriate level, they can boost both employment and wages by increasing workers' effort and productivity and can even contribute to a higher share of workers being employed in high-productivity firms.

Redefining this narrative is also important because labor markets in Latin America and the Caribbean do not fit the familiar two-sided model of large employers on one side and wage workers on the other, with labor and social policies mediating that relationship. The "traditional" employee in a private firm constitutes only 50 percent of total employment. In 2024, nearly half of all workers in the region—46 percent—were either self-employed or employed in microenterprises with fewer than five workers. When unpaid family workers in small businesses are included, this share rises to 50 percent. While we do recommend policies to mitigate the market power of large employers, policy design must also recognize that most workers in the region work either for themselves or as employees in small firms with limited labor market power.

The "traditional" employee in a private firm accounts for just 50 percent of employment—nearly half the region's workers are self-employed or in microenterprises.

Building on this perspective, the book presents policy recommendations that combine disruptive structural changes with more gradual improvements and institutional reforms. These recommendations are organized around three objectives: (i) modernizing core labor regulations and social security institutions; (ii) improving the credibility and effectiveness of labor enforcement and justice systems; and (iii) strengthening skills development and active labor market policies.

1.4 How Is the Rest of This Book Organized?

The book follows this chapter with a diagnostic of labor markets in the region and their evolution over time (Chapter 2), then turns to an explanation of the distinct features of labor markets and the role of government regulation and labor policy (Chapter 3). It then examines the current state and evolution of key institutions governing relationships between employers and workers (Chapter 4), social protection systems (Chapter 5), and active labor market policies and skills development (Chapter 6). Chapter 6 also presents new evidence on skills mismatches in the region. Building on this, Chapter 7 analyzes labor costs and

their implications for firms and employment. Chapter 8 then presents a set of concrete and actionable policy recommendations aimed at improving productivity and workers' welfare. While a regional perspective cannot fully capture the idiosyncrasies of individual countries, the recommendations remain specific and are illustrated with examples.

Chapter 9 offers final remarks and general conclusions. It also acknowledges that while some policies are readily implementable, many of the reforms discussed in the book are not easy. Some require political consensus; others demand careful design, close coordination across policies that are often treated as unrelated, and sustained commitment to long-term goals. In fact, some countries in the region have already made important progress, while others can follow. Throughout the book, we make the case that the effort is difficult—but indispensable.



2

Three Decades of Modest Progress and Emerging Challenges in Labor Markets



THIS CHAPTER IN FIVE POINTS

1 Labor markets have improved over the past three decades, but progress has been slow and has stalled in recent years. Women's entry into the labor force drove participation gains, labor market slack declined, and formal employment increased, albeit modestly. Real labor income grew only 18 percent over thirty years, roughly half of the OECD's pace. Most gains in key indicators have stalled since the mid-2010s, leaving the region far from convergence with advanced economies.

2 Weak productivity growth underlies the region's modest labor market improvements. GDP growth has been driven primarily by factor accumulation, not overall productivity gains. Labor productivity has stagnated for decades across the region.

3 The fundamental structure of labor markets remains largely unchanged, constraining productivity growth. Forty-six percent of workers continue to be concentrated in small, low-productivity firms and in self-employment, with a persistent "missing middle" of medium-sized firms. Informality remains widespread, and job stability is low. Only about 28 percent of workers in the region hold what could be called a "standard" job: wage employment in a private firm with social security.

4 Labor markets in the region remain unequal and segmented across population groups.

Significant disparities persist by sex, age, education, ethnicity, and disability in access to jobs, formality, and earnings. While part of these gaps reflects differences in human capital, substantial inequalities across gender and ethnic groups remain even after controlling for education and experience.

5 Technological change and demographic transitions are adding new pressures to already fragile labor markets.

New forms of work, such as telework and platform work, are expanding but remain limited and unequal in access. At the same time, automation risks are rising, and the demographic dividend is ending, with aging populations and slower labor force growth placing increasing strain on employment systems, productivity, and social protection.

2.1 The Labor Market Landscape in Latin America and the Caribbean

What do we know about labor markets in Latin America and the Caribbean over the past three decades—and what challenges lie ahead? This chapter addresses these questions and sets the stage for the institutional and policy analysis in the chapters that follow. The data analysis reveals three central messages.

The pace of improvement falls well short of what the region's people deserve and what its potential allows.

First, labor market conditions in Latin America and the Caribbean have improved modestly over the past thirty years, but the pace of progress has been insufficient to close the gap with advanced economies. Furthermore, progress has generally slowed over the last decade. Favorable demographic dynamics, rising female labor force participation, and sustained improvements in educational attainment have increased the supply of more educated workers and contributed meaningfully to growth in GDP per capita in the region. Labor market slack declined as unemployment, underemployment, and discouragement fell, while labor formality increased in most countries, expanding access to social security. Real labor incomes rose, and the share of workers earning below the poverty line declined, signaling improved access to jobs that offer greater stability, protection, and compensation. Yet despite these gains, the region has failed to converge toward advanced economies across these indicators; at best, progress has mirrored—and often lagged behind—that of richer countries. Overall, while some progress has been made, the pace of improvement falls well short of what the region's people deserve and what its potential allows.

Second, despite measurable improvements, the underlying structure of labor markets in Latin America and the Caribbean remains largely unchanged. Employment continues to be concentrated in small, low-productivity firms, and labor markets remain highly segmented. Informality persists at high levels, with nearly half of workers lacking social security coverage and informal employment prevalent even within formal firms. Wage employment dominates, but self-employment is excessive compared with the levels observed in advanced economies and largely functions as a buffer against labor market shocks rather than a pathway to productivity growth. Job stability remains limited, preventing young workers from accumulating job-specific experience and improving productivity, contributing to income volatility and weak accumulation of social security entitlements. Moreover, labor market outcomes continue to differ sharply by sex, race, age, and education, underscoring the persistence of deep-rooted inequalities and the uneven distribution of progress.

Third, technological change and demographic transitions are intensifying existing labor market challenges and creating new pressures on employment, skills, and social protection systems. New work arrangements have emerged as a result of improvements in internet connectivity and preferences for flexibility. Following a temporary surge during the COVID-19 pandemic, telework accounted for only 1.5–5 percent of employment in 2023 and remains concentrated among high-income, highly educated workers, limiting its potential to reduce gender or income gaps. Platform work has expanded rapidly but still represents a small share of total employment. Although the adoption of these forms of work has been smaller than anticipated, they still pose regulatory and social protection challenges that will be discussed in the following chapters. At the same time, the diffusion of automation and artificial intelligence has been limited in aggregate, yet exposure is expected to rise sharply, increasing risks of job displacement and skills mismatches. These technological shifts are unfolding amid a rapid demographic transition: the demographic dividend that supported labor income growth for decades is fading as fertility declines and population aging accelerates, with the working-age population share projected to begin falling from 2027 onward. Together, slow productivity growth, rising automation risks, and an aging workforce threaten long-term income growth and place increasing strain on employment systems, skills development, and the sustainability of social protection frameworks.

Slow productivity growth, rising automation risks, and an aging workforce together threaten long-term incomes and the sustainability of social protection.

The chapter is organized around these three messages. Drawing mainly on harmonized household survey data spanning up to thirty years, the chapter documents long-term trends in labor market outcomes. To identify more recent trends in labor markets, we also employ a wider array of sources, such as vacancy data, specific surveys, and demographic projections. Whenever possible, the analysis relies on long, harmonized time series constructed from household surveys, although data availability limits some indicators to shorter periods. Recognizing the heterogeneity across countries, the chapter explores cross-country differences whenever feasible and includes the broadest possible country coverage. Appendix 1 provides detailed information on data sources and harmonization methods, while Appendix 9 defines key indicators and concepts.

2.2 Slow Labor Market Progress, Limited Convergence

Over the past thirty years, there has been modest progress in labor market indicators, but the pace of improvement has been insufficient to converge toward advanced economies.

2.2.1 A More Educated and Larger Workforce Fueled Growth

One positive development over the last thirty years is that favorable demographics, rising female labor force participation, and improvements in educational attainment have led to an influx of more workers with higher levels of education into the labor market, which has been the most important driver of GDP per capita growth in recent decades.

Between 1995 and 2024, total labor force participation rates in the region—the share of the working-age population that was employed or actively seeking work—increased from 66 to 70 percent of the working-age population.² Higher participation also led to more employment, as overall employment rates for the working-age population increased from 62 to 66 percent. Most of the gains in both participation and employment occurred before 2014, when participation had already reached 70 percent and employment 65 percent. In sum, the labor force grew because the working-age population expanded and a larger share of people worked or sought work.

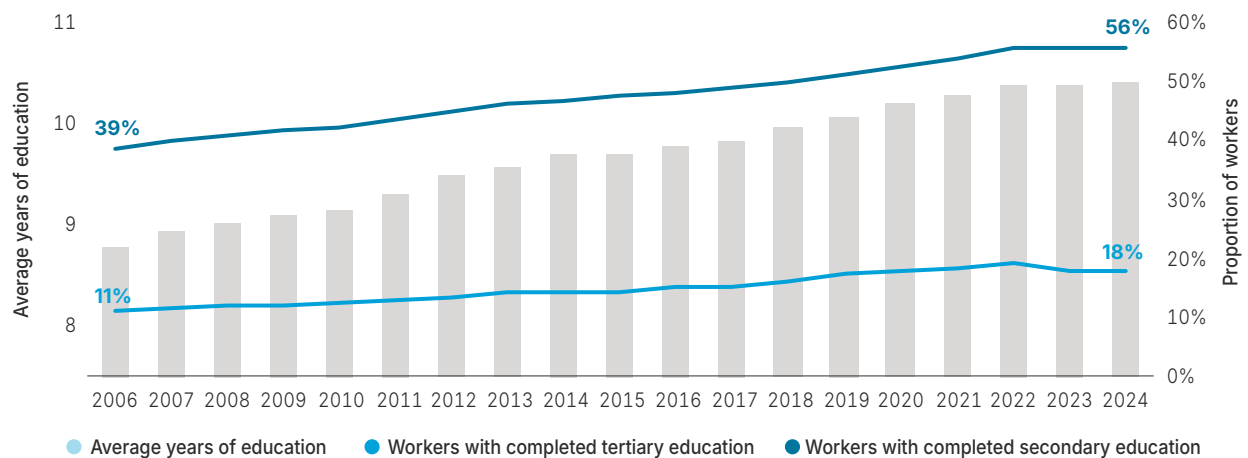
Not only did more workers enter the labor market, but they also did so with higher levels of education. In 2024, the average worker had nearly two additional years of schooling compared with 2004, raising the regional average to almost 11 years of education. As shown in Figure 2.1, the share of workers who completed secondary education increased to 56 percent in 2024 (17 percentage points higher than in 2006), while the proportion with tertiary education rose to 18 percent, a gain of 7 percentage points. The largest increases in tertiary attainment occurred in Chile and Colombia, where gains exceeded 15 percentage points, followed by Brazil and Paraguay, with increases of 12 and 9 percentage points, respectively, since 2006.

A cohort analysis provides an even clearer picture of this transformation. Young people entering the labor market today are far better educated than previous generations. For example, Generation Z (born between 1997 and 2012) reached adulthood with an increase of more than 25 percentage points in the share of workers completing secondary education compared with Generation X (born between 1965 and 1980) when both cohorts were between 20 and 24 years old (see Figure 2.2). A similar pattern emerges when comparing

2. Based on the simple average of 17 Latin American and Caribbean countries with comparable data.

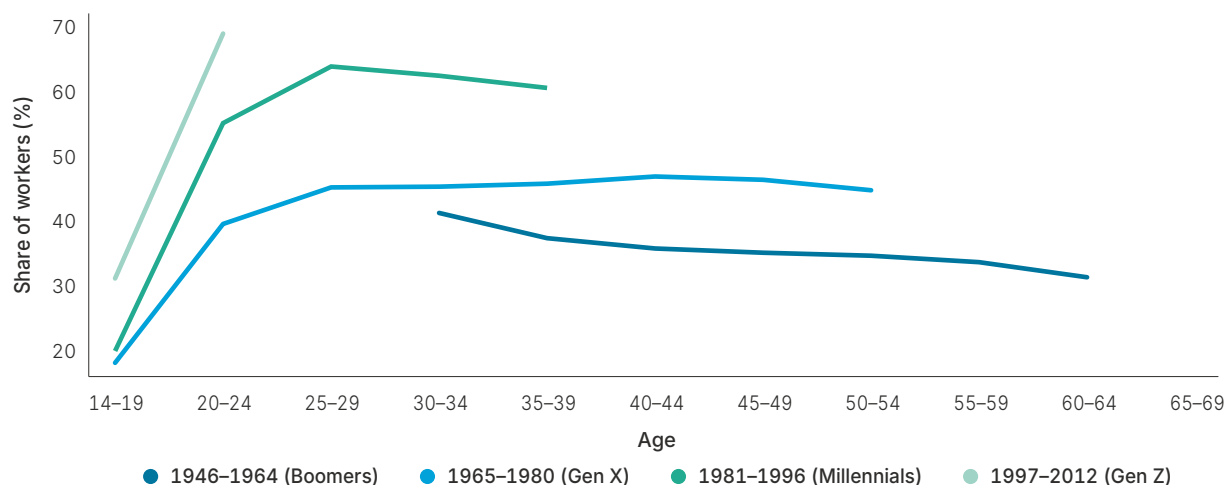
Generation X with the baby boomers (born between 1946 and 1964). As Generation X workers moved through their 30s and 40s, their rates of secondary education completion surpassed those of baby boomers at the same age. A similar pattern emerges when comparing tertiary educational attainment across generations.

FIGURE 2.1 EVOLUTION OF EDUCATIONAL ATTAINMENT (LAC-16)



Source: Authors' calculations, based on an unweighted average of 16 Latin American and Caribbean countries, using IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

FIGURE 2.2 SHARE OF WORKERS WITH COMPLETE SECONDARY EDUCATION, BY GENERATION (LAC-16)

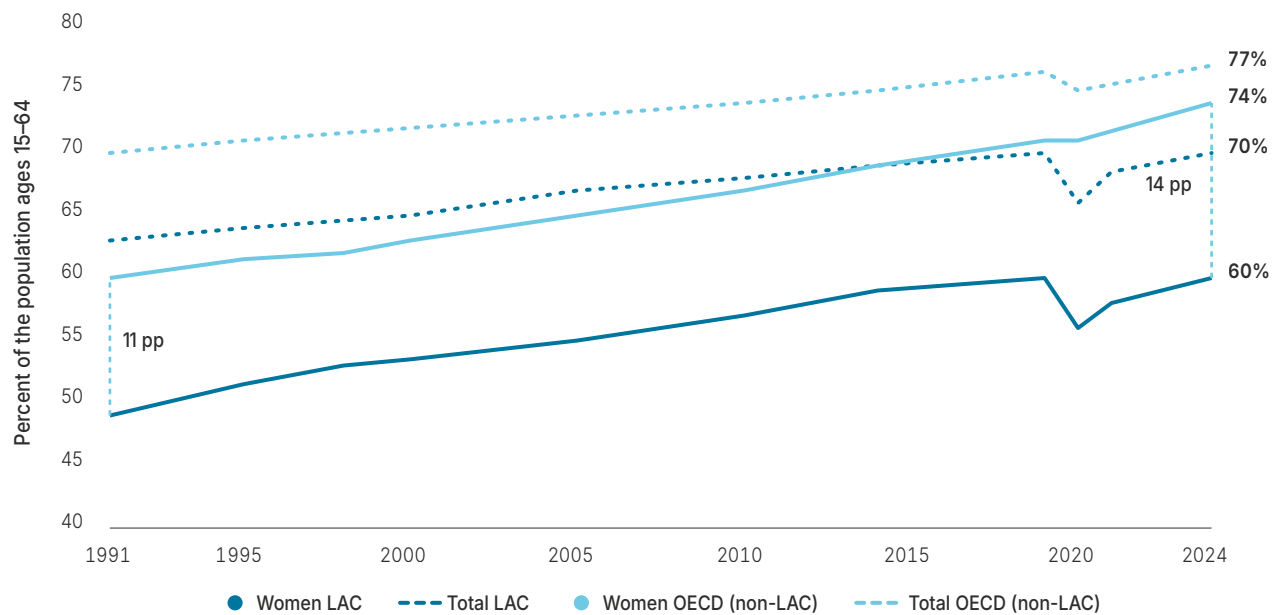


Source: Authors' calculations, based on an unweighted average of 16 Latin American and Caribbean countries, using IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

The increase in educational attainment and changes in gender dynamics played an important role in the overall evolution of labor force participation rates. On the one hand, better access to education meant that more women joined the labor force (Araujo et al. 2024). Figure 2.3 shows that between 1991 and 2024, the average female participation rate in the region rose from 49 to 60 percent of the working-age population (15–64), according to International Labour Organization (ILO) estimates. There are important differences across countries. For instance, some countries in the Caribbean and South America have reached female labor force participation rates similar to or even higher than the OECD (non-LAC) average of 74 percent (see Figure 2.4). However, female participation rates in Central America are often below 55 percent, and these countries also show the largest gaps relative to male participation rates. On the other hand, male participation rates declined from 83 to 80 percent, also largely due to increased educational attainment and later entry into the labor market. In general, the increase in female participation rates more than offset the reduction in male participation rates. Between 1991 and 2024, total participation rates increased from 66 to 70 percent of the working-age population.

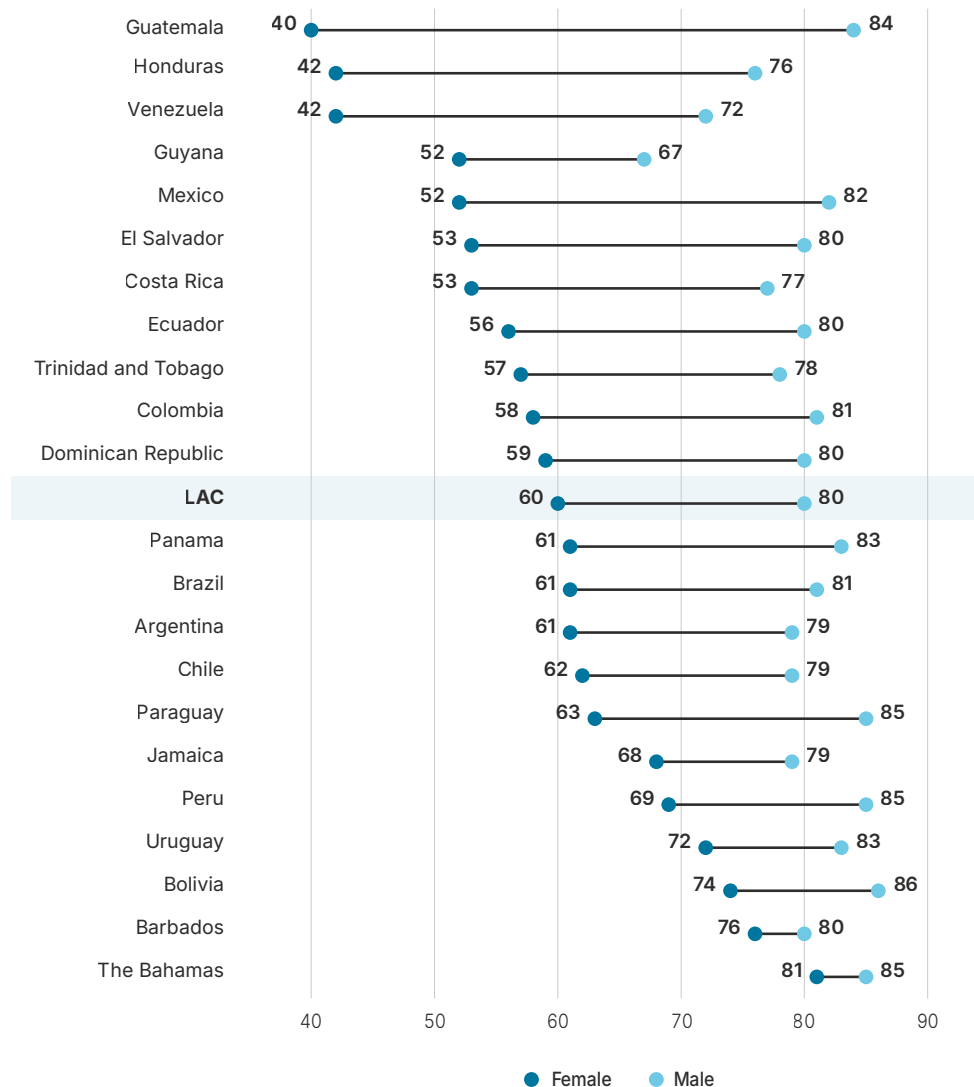
However, the pace at which women have been entering the labor force has slowed, and their participation rates are no longer converging toward OECD levels. Between 1991 and 1998, the gap in female labor force participation between Latin America and the Caribbean and the OECD countries narrowed from 11 to 9 percentage points, reaching its lowest point in 1998. The gap remained around 10 percentage points for the next two decades. In the last decade, however—and especially after the COVID-19 pandemic—the gap has widened again. By 2024, female participation rates in Latin America and the Caribbean were 14 percentage points below those of non-Latin American OECD countries. This slowdown, together with the decline in male participation, has led to stagnation in total labor force participation rates, as most of the gains occurred before 2014. The fact that female labor force participation is showing signs of slowing is particularly troubling, suggesting that progress should no longer be assumed to continue without specific actions to sustain it.

FIGURE 2.3 FEMALE AND TOTAL LABOR FORCE PARTICIPATION RATES, 1991–2024 (LAC-22)



Source: Authors' calculations, using ILO modeled estimates (labor force participation rate, total, percent of total population ages 15–64).

FIGURE 2.4 LABOR FORCE PARTICIPATION RATE BY COUNTRY AND SEX, 2024



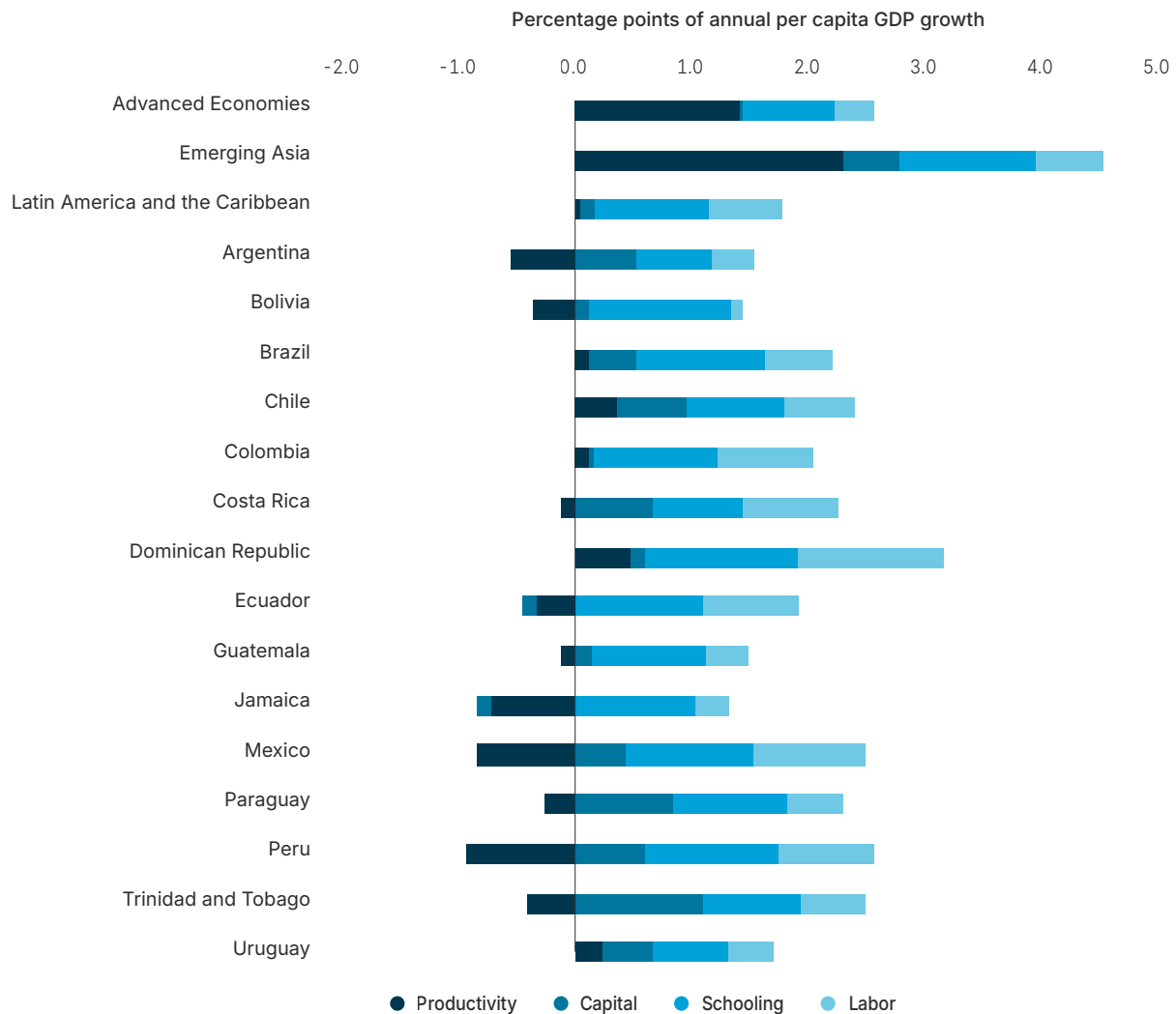
Source: Authors' calculations, based on an unweighted average of 22 Latin American and Caribbean countries, using ILO modeled estimates (labor force participation rate, total, percent of total population ages 15–64).

Note: Countries sorted by female participation rate.

Increases in the labor force and educational attainment contributed to economic growth. The rise in educational attainment has made a significant contribution to per capita GDP growth in the region, despite persistent challenges related to the quality and relevance of education, issues we address in more detail in Chapter 6. On average, improvements in schooling accounted for approximately 1 percentage point of annual per capita GDP growth between 1960 and 2019 (see Figure 2.5). This contribution is higher than that observed in

advanced economies (0.8 percentage points) over the same period, although slightly below that of emerging Asian economies (1.2 percentage points). Overall, the steady improvement in educational attainment has been a key driver of per capita GDP growth in the region. In fact, Figure 2.5 shows that labor force expansion was the second most important contributor to per capita GDP growth in the region between 1960 and 2019. A large share of this growth reflects the steady rise in the proportion of the population that is of working age. However, as discussed later in this chapter, the demographic dividend that supported this expansion is coming to an end, and the region is poised to confront the challenges of rapid population aging.

FIGURE 2.5 DECOMPOSITION OF PER CAPITA GDP GROWTH RATES, 1960–2019



Source: Authors' calculations, based on Penn World Table, version 10.01.

2.2.2 Beyond Unemployment: The Hidden Gap in Labor Utilization

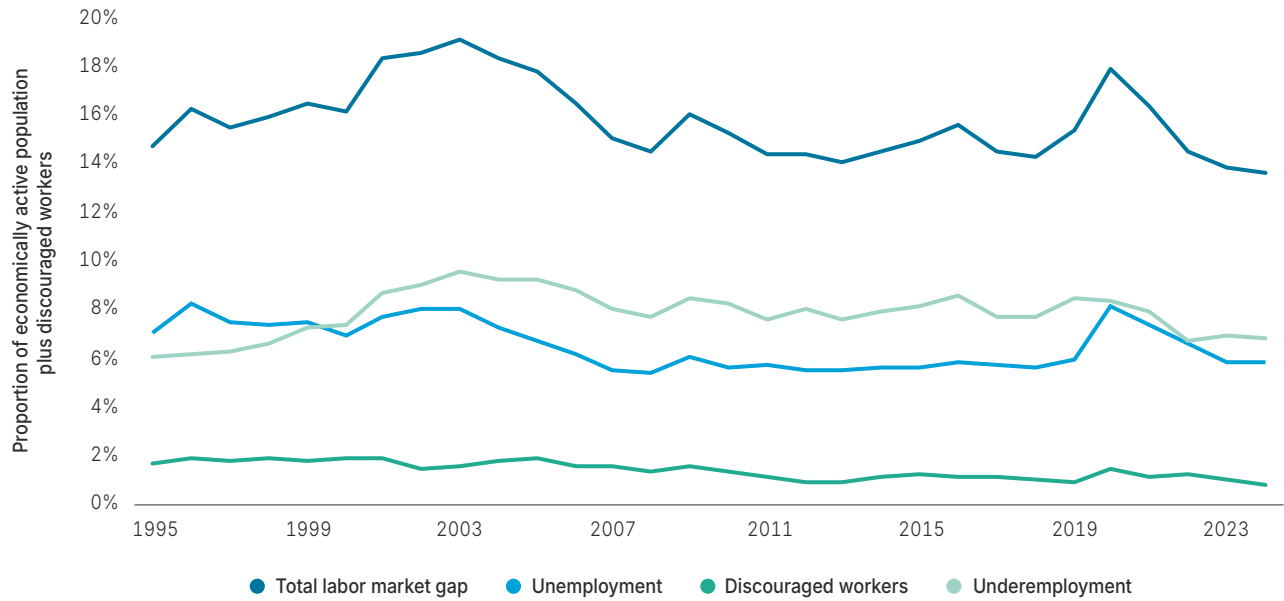
Over the past three decades, the region has made some progress in reducing the labor market gap, understood as the share of potential workers whose labor is underutilized because they are unemployed, working fewer hours than they would like, or discouraged from seeking work. Despite these modest gains, the labor market gap in Latin America and the Caribbean remains roughly twice as high as in the United States.

The most widely used indicator of labor underutilization, the unemployment rate—which measures the share of people actively seeking work but unable to find it—fell from 8 percent in 1995 to 6 percent in 2024³ (see Figure 2.6). However, unemployment alone does not capture the full extent of labor market challenges. Many workers counted as “employed” would like to work more hours but cannot find suitable jobs, while others, after repeated unsuccessful attempts, leave the labor force entirely, becoming discouraged workers (Kaplan 2021). When these groups are included, a more complete picture of labor underutilization emerges. In 2024, unemployment (5.9 percent), underemployment (6.8 percent), and discouraged workers (0.8 percent) together amounted to a labor market gap of 13.5 percent, only slightly lower than the 15 percent observed in 1995. Although there were periods of improvement and deterioration over the years, the overall reduction in the labor market gap has been minimal. For perspective, the labor market gap in a sample of 11 countries of the region was about double that of the United States in 2023 (Bureau of Labor Statistics 2023). There are also substantial differences across Latin American countries. In Uruguay, the labor market gap is close to 20 percent; in Panama, Honduras, Ecuador, and Costa Rica, it is above 15 percent (Figure 2.7). Moreover, although most countries reduced their labor market slack between 2004 and 2024, Honduras and El Salvador experienced increases in the share of workers who are unemployed, underemployed, or discouraged (Figure 2.7).

3. Figure 2.6 depicts the average for LAC–11, but the average for a broader set of countries (LAC–17) also confirms that average unemployment rates decreased during this period.

2 Three Decades of Modest Progress and Emerging Challenges in Labor Markets

FIGURE 2.6 TOTAL LABOR MARKET GAP (LAC-11)

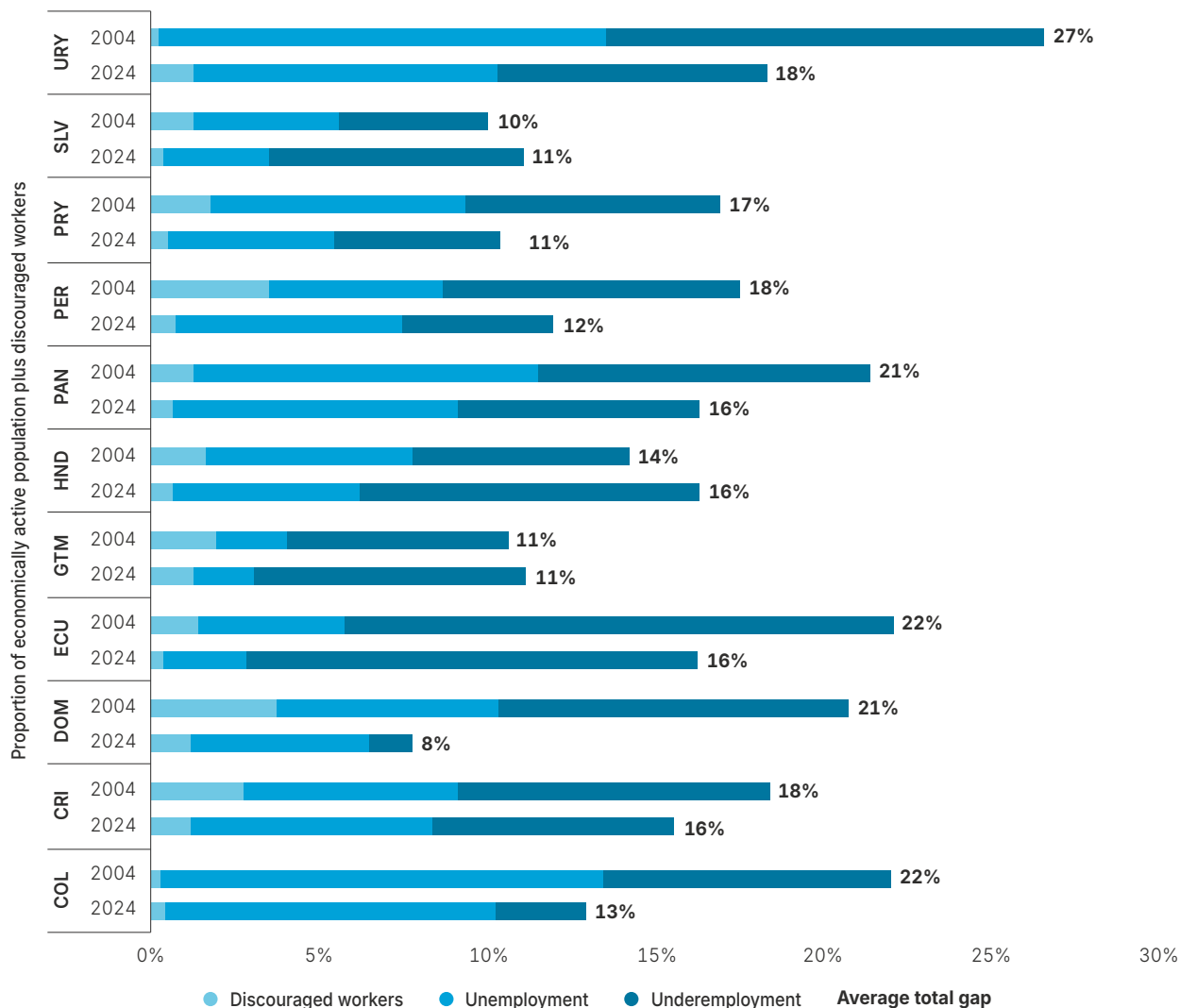


Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The Latin America and the Caribbean average is an unweighted average of 11 countries with interpolated values for missing years. The labor market gap is calculated using the economically active population plus discouraged workers as the denominator.

2 Three Decades of Modest Progress and Emerging Challenges in Labor Markets

FIGURE 2.7 LABOR MARKET GAP BY COUNTRY, 2004 AND 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The Latin America and the Caribbean average is an unweighted average of 11 countries, with interpolated values for missing years. The labor market gap is calculated using the economically active population plus discouraged workers as the denominator.

Still, this broader measure does not fully capture all dimensions of labor slack in the region. The labor market gap can also underestimate underutilization in economies with high informality—such as those in Latin America and the Caribbean—since many informal jobs mask insufficient formal labor demand (IMF 2021). The silver lining is that informality has also been gradually declining, helping to narrow this broader measure of labor market slack.

2.2.3 More Formal Jobs, but Not Nearly Enough

Formality is a central dimension of job quality and is defined in this book as the share of workers who contribute to social security.⁴ Contributing to social security, in this case to a pension system, is closely associated with access to key protections, including health insurance, coverage against occupational hazards, and other forms of income security, as well as with greater employment stability and legal protections at work. As such, formality reflects not only compliance with labor and social security regulations, as later chapters discuss, but also the extent to which jobs provide workers with protection against risks over the life cycle. Higher levels of formality are therefore indicative of better-quality employment.

Figure 2.8 shows that labor formality in the region increased over the past two decades, with the average rate rising from 38 percent in 2004 to 46 percent in 2024. While this represents meaningful progress, the pace has been uneven across employment categories. Gains have been driven primarily by wage workers, whose formality rate increased from 53 to 62 percent, whereas improvements among the self-employed were more limited, rising from 12 to 18 percent. Notably, progress among private sector employees has been particularly slow. Formality in this group increased by only 5 percentage points over two decades—from 34 to 39 percent—and has largely stagnated over the past decade. This pattern suggests that institutional barriers within the private sector, including high labor costs, regulatory complexity, and limited enforcement capacity, continue to constrain formal job creation, highlighting the need for targeted policy interventions to accelerate formalization. This will be discussed in more detail in the following chapters.

Besides work categories, Figure 2.9 shows that progress in labor formality has also been uneven across countries. Over the past two decades, most countries experienced gains in labor formality, with the notable exceptions of Venezuela, Panama, and Guatemala. Several countries recorded particularly strong improvements: labor formality increased by 18 percentage points in Uruguay, 17 in Colombia, 16 in Brazil, and 12 in Costa Rica. Sharp

4. Mainly defined as contributions made to a public or private pension system—excluding health-related contributions—typically linked to a person's main or secondary job.

contrasts also emerge when comparing levels of formality. In 2024, more than 70 percent of workers in Uruguay, Chile, and Costa Rica contributed to social security, compared with only about 20 percent in Guatemala, Peru, and Bolivia.

To analyze in more detail some of the drivers of formality increases by country, in Figure 2.10, we decompose the overall change in formality using a shift-share analysis that separates the impact of employment composition from shifts in group-specific formality rates. The composition effect measures how changes in the relative share of wage versus independent workers influence overall formalization, while the shift effect captures changes in the inherent formality rates within each group (see Appendix 3 for more details).

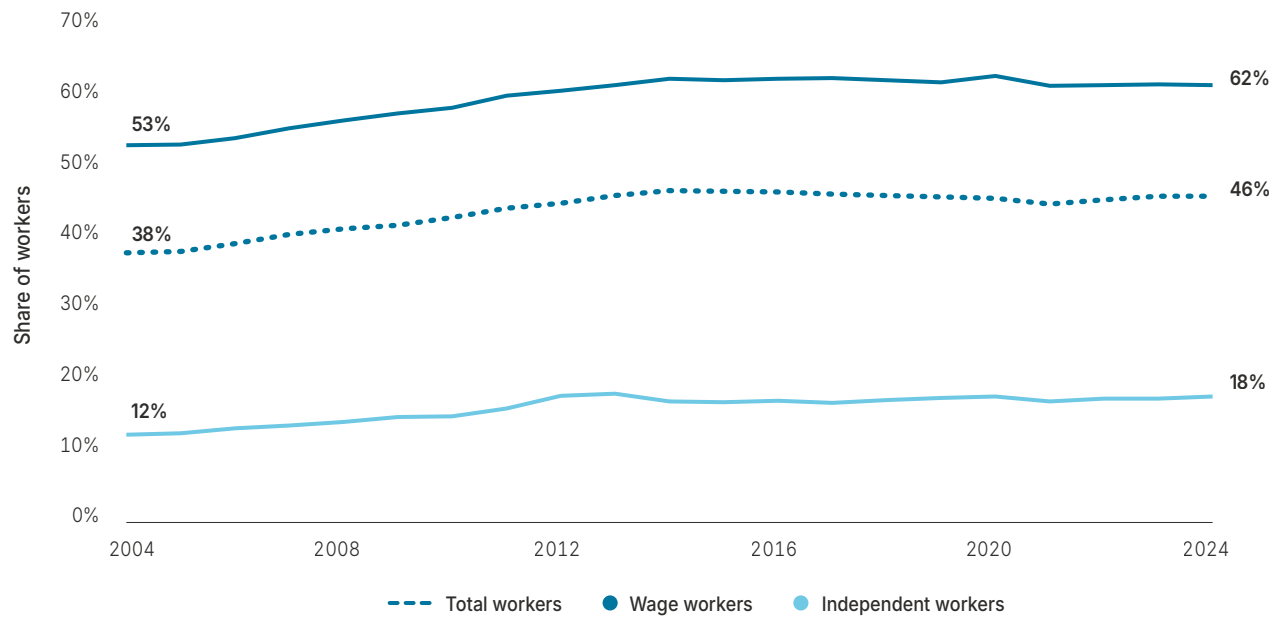
On average, the formalization of wage work accounted for more than 70 percent of the growth in formality between 2004 and 2024. This means that wage work is more likely to be formal now than it was twenty years ago. However, with the exception of the Dominican Republic, the countries with the greatest increases in formality over the last two decades—Uruguay, Brazil, Costa Rica, and Colombia—also had notable increases in the formality rate of independent workers that contributed positively to overall formalization. The composition of job types—that is, the proportion of workers doing wage work—also contributed to rising formality rates, but not in all countries. El Salvador, Guatemala, and Venezuela show a decrease in the formality rate of wage work, meaning wage workers are now less likely to be enrolled in social security than they were twenty years ago. In Panama, formality rates decreased due to a decline in the proportion of wage workers and an increase in the proportion of self-employed workers, who are more likely to be informal.

A cohort analysis shows some encouraging news for younger generations. Figure 2.11 shows that workers born between 1981 and 1996, known as Millennials, had a higher probability of holding formal jobs between the ages of 20 and 40 than workers born between 1965 and 1980 (Generation X). Access to social security and earlier participation in retirement savings can generate substantial long-term benefits, leading to higher pension income later in life.

Despite this progress, still less than half of workers in the region are formal, and the rate of progress is slow and insufficient. Most of these improvements occurred before 2014, and the trend has since flattened. At this pace, it would take more than 80 years to increase the average regional labor formality rate for all workers from 46 to 79 percent, the level seen in Uruguay, the most formal economy in the region.

2 Three Decades of Modest Progress and Emerging Challenges in Labor Markets

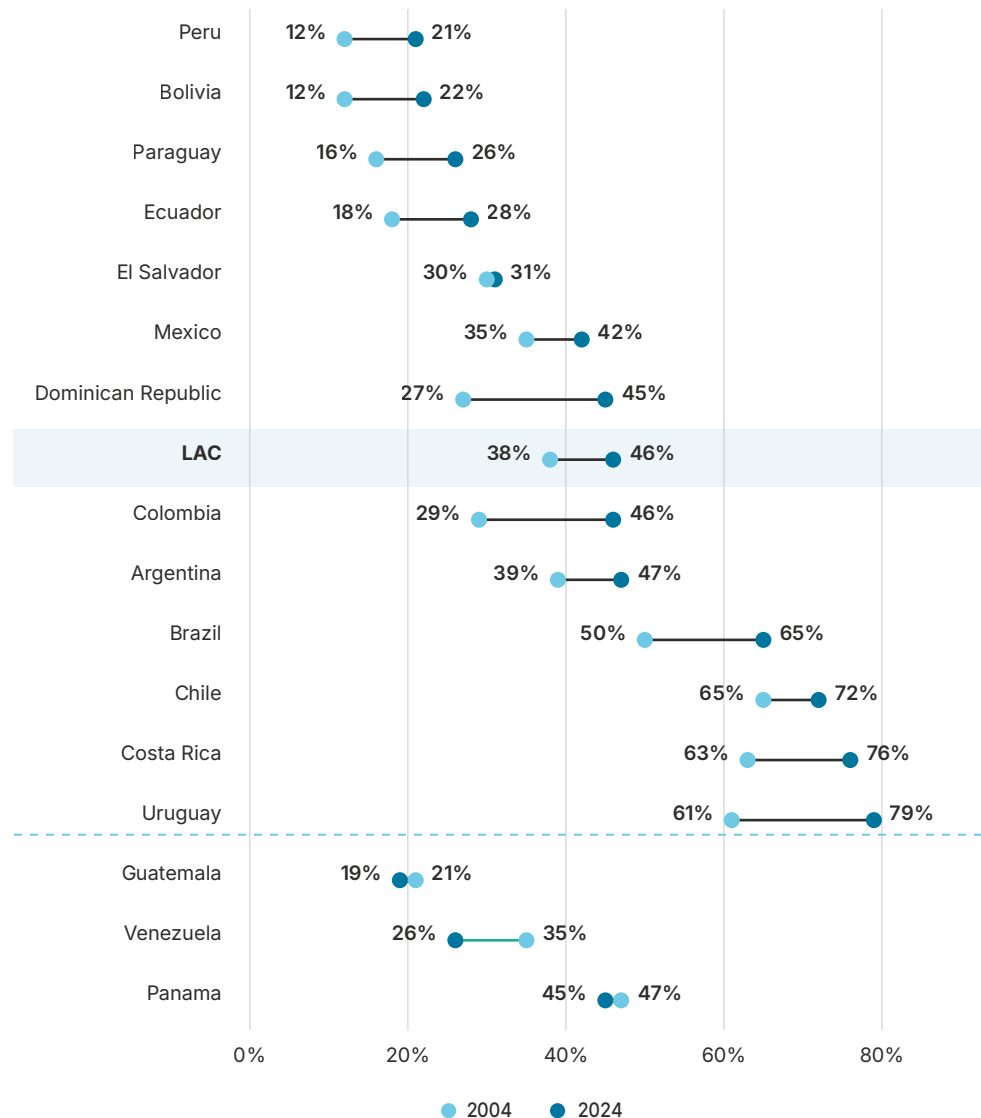
FIGURE 2.8 EVOLUTION OF THE SHARE OF FORMAL WORKERS BY CATEGORY (LAC-13)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The regional average covers 13 Latin American and Caribbean countries. Values are interpolated for missing years. The earliest data are from 2006 for Colombia, 2008 for Mexico, 2010 for Guatemala, and 2006 for the Dominican Republic. Formalization rates for independent workers are not observed in Argentina, Peru, or Paraguay. The earliest available data for Bolivia are from 2012.

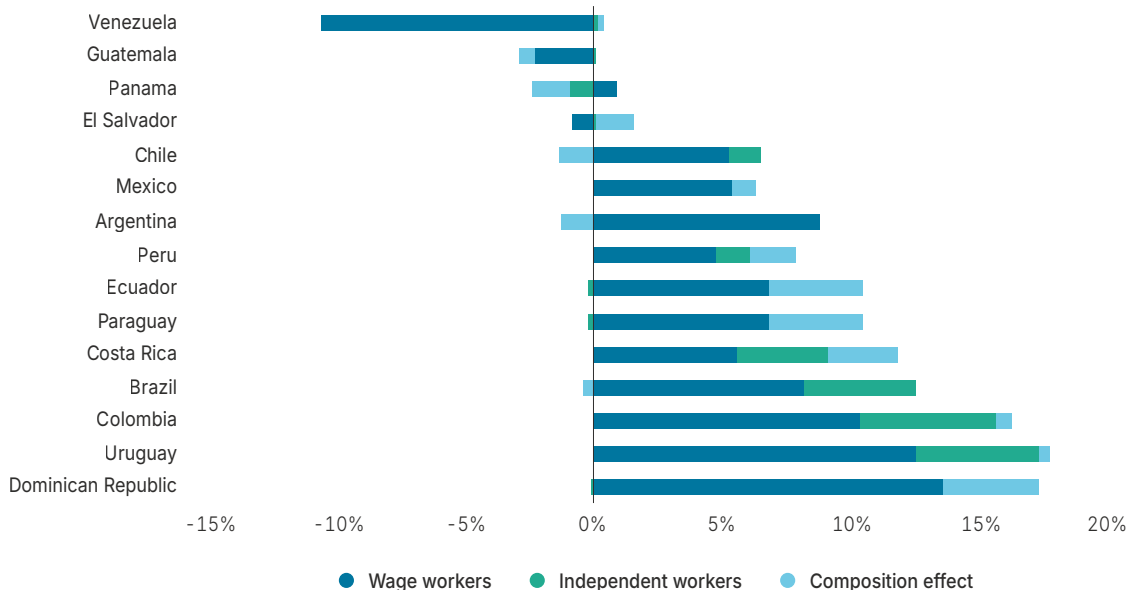
FIGURE 2.9 SHARE OF FORMAL WORKERS BY COUNTRY, 2004–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

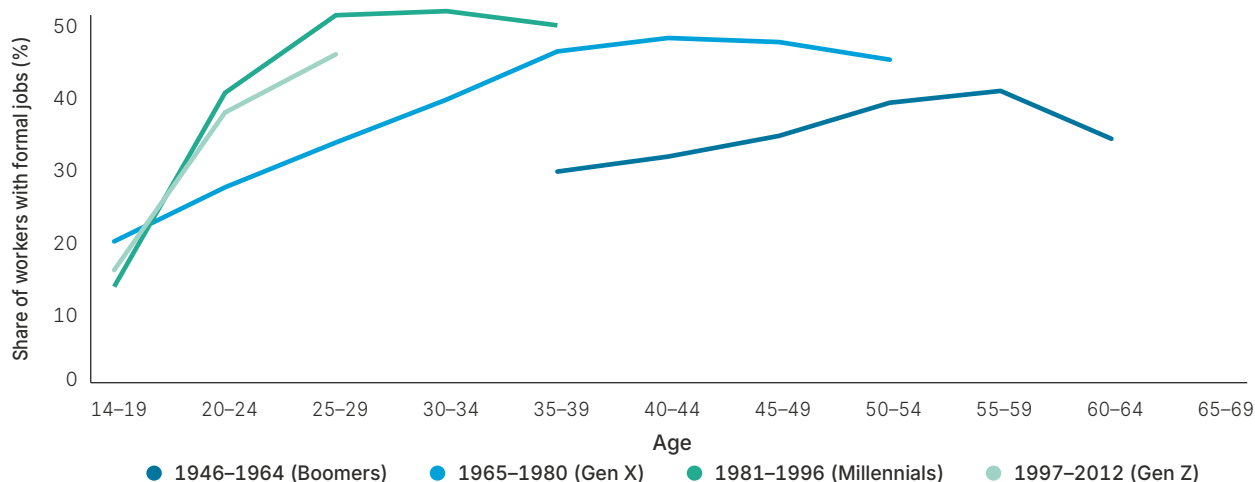
Note: In green, the countries where the share fell between 2004 and 2024. The regional average covers 13 Latin American and Caribbean economies for 2004 and 2024, or the latest available year. The earliest data are from 2006 for Colombia, 2008 for Mexico, 2010 for Guatemala, and 2006 for the Dominican Republic. Formalization rates for independent workers are not observed in Argentina, Peru, or Paraguay. The earliest available data for Bolivia are from 2012.

FIGURE 2.10 DECOMPOSITION OF FORMALITY GROWTH BY SUBCOMPONENT, 2004–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.
Note: The regional average covers 13 Latin American and Caribbean economies for 2004 and 2024, or the latest available year. The earliest data are from 2006 for Colombia, 2008 for Mexico, 2010 for Guatemala, and 2006 for the Dominican Republic. Formalization rates for independent workers are not observed in Argentina, Peru, or Paraguay. The earliest available data for Bolivia are from 2012.

FIGURE 2.11 SHARE OF FORMAL WORKERS BY GENERATION



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.
Note: The regional average covers 13 Latin American and Caribbean economies for 2004 and 2024, or the latest available year. The earliest data are from 2006 for Colombia, 2008 for Mexico, 2010 for Guatemala, and 2006 for the Dominican Republic. Formalization rates for independent workers are not observed in Argentina, Peru, or Paraguay. The earliest available data for Bolivia are from 2012.

2.2.4 Improvement in Labor Compensation and Reduction of Working Poverty

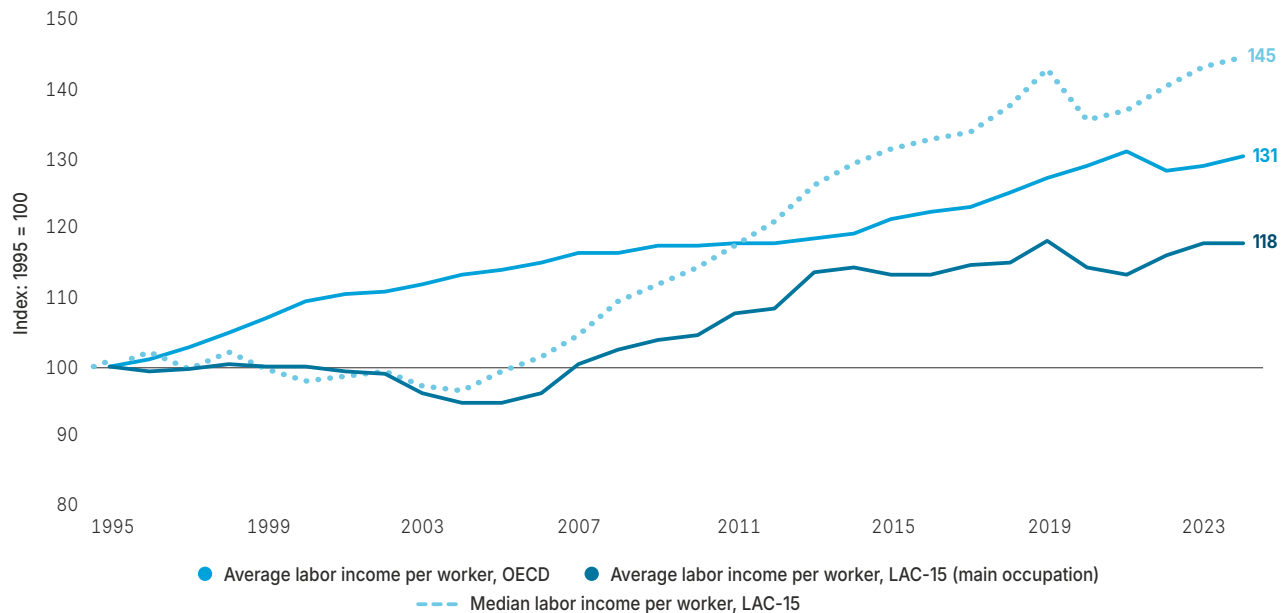
Labor income constitutes the primary source of income for households in Latin America and the Caribbean and represents the most important channel for reducing poverty and vulnerability. As a result, its level, stability, and growth are central components of job quality. Improvements in labor income not only raise living standards but also shape inequality and resilience to shocks, making labor earnings a critical mechanism through which labor markets contribute to inclusive growth and poverty reduction.

Over the past three decades, real labor income per worker in Latin America and the Caribbean has improved somewhat, but not fast enough to close the gap with high-income economies. Because this measure captures the share of output that goes directly to workers—their wages, salaries, bonuses, and benefits—it offers a window into how the region's workers have fared. After being battered by the economic crises of the late 1990s and early 2000s, real labor income per worker began to climb again in the early years of the twenty-first century. The recovery was gradual, but it helped undo much of the earlier loss: between 1995 and 2024, average real labor income per worker rose by 18 percent across the region. Still, this improvement paled in comparison with the 31 percent growth recorded in OECD countries over the same period (see Figure 2.12), and most of the growth occurred before 2014.

Average real labor income per worker rose just 18 percent over three decades—roughly half the pace of the OECD.

These regional averages conceal substantial cross-country differences. In 2024, workers in Panama and Uruguay earned, on average, around two and a half times as much as those in Honduras and Peru (Figure 2.13). The rates of improvement in real labor income have also differed. While some economies experienced sizable gains—most notably Colombia—others followed the opposite trajectory. Over the same period, real labor income per worker declined by double digits in Guatemala. Countries with the highest increases between 1995 and 2024 consistently reported similar growth rates in GDP per capita and labor income, as noted in the introduction.

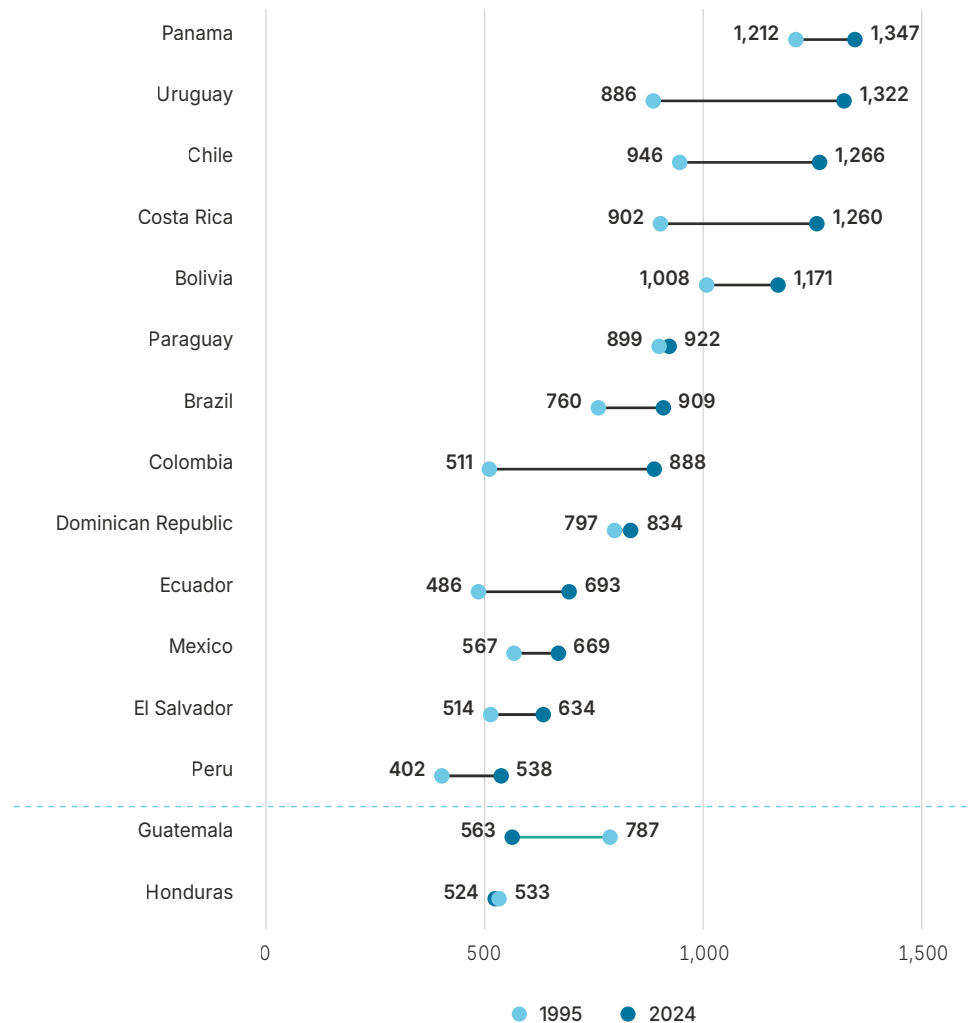
FIGURE 2.12 EVOLUTION OF REAL LABOR INCOME PER WORKER (LAC-15), 1995–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, excluding Argentina and Venezuela (sample of 15 countries); average annual wage data are from the OECD.

Note: The earliest available data for Colombia, Ecuador, and Guatemala are from 2000; Peru and Chile take values from 1997 and 1996, respectively. Values are interpolated for missing years.

FIGURE 2.13 REAL MONTHLY LABOR INCOME PER WORKER, LAC COUNTRIES, 1995 AND 2024 (US\$, 2017 PPP)



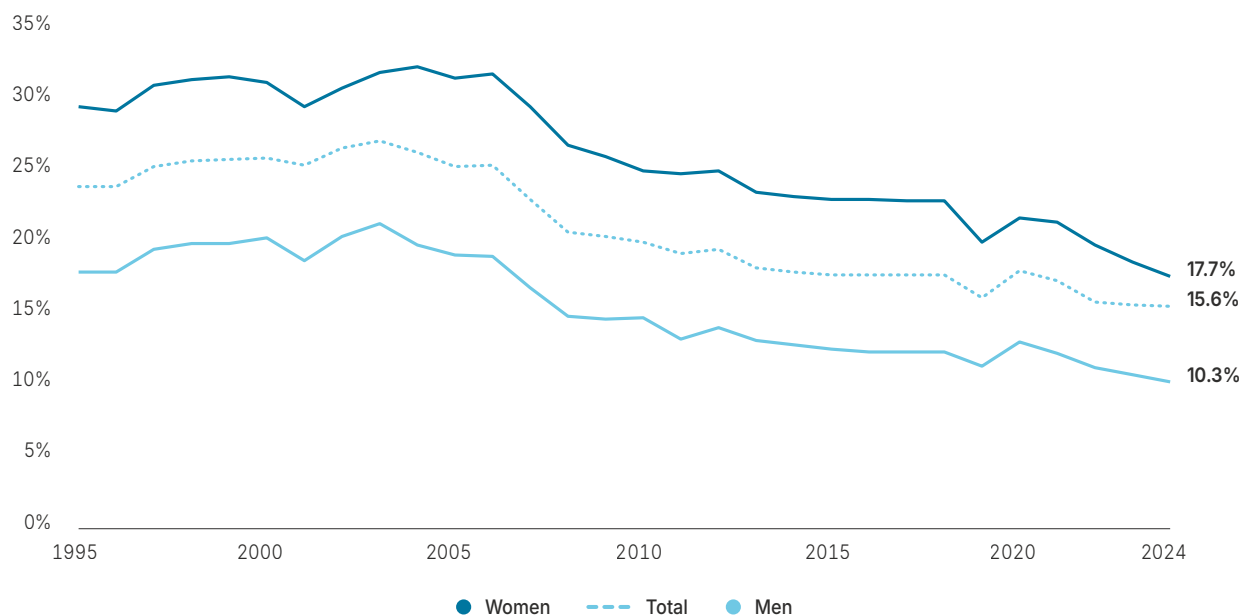
Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, excluding Argentina and Venezuela (sample of 15 countries); average annual wage data are from the OECD.

Note: In green, the countries where real monthly labor income per worker fell between 1995 and 2024. The earliest available data for Colombia, Ecuador, and Guatemala are from 2000; Peru and Chile take values from 1997 and 1996, respectively. Values are interpolated for missing years.

Workers with less education saw the largest improvements in real labor income, reducing inequality. From 2006 to 2024, real labor income for workers with primary schooling or less increased by 39 percent, while income for those with complete secondary education increased by only 5 percent. As a result, income inequality narrowed noticeably: in 2004, the average person earned 3.1 times as much as the poorest 10 percent, and the richest 10 percent earned nearly 14 times as much; by 2024, those ratios had shrunk to 2.7 and 10.6, respectively.

As incomes rose, labor poverty also decreased. Between 1995 and 2024, the share of workers falling below the international poverty line for middle-income countries (US\$6.85 per day) decreased by 8 percentage points. Despite overall gains, large cross-country disparities persist: while countries such as Peru, Colombia, Ecuador, and Brazil achieved substantial reductions, others, such as Panama, saw increases, and labor poverty rates in 2024 still ranged widely—from 32 percent in Honduras to just 5 percent in Chile (Figure 2.14 B).

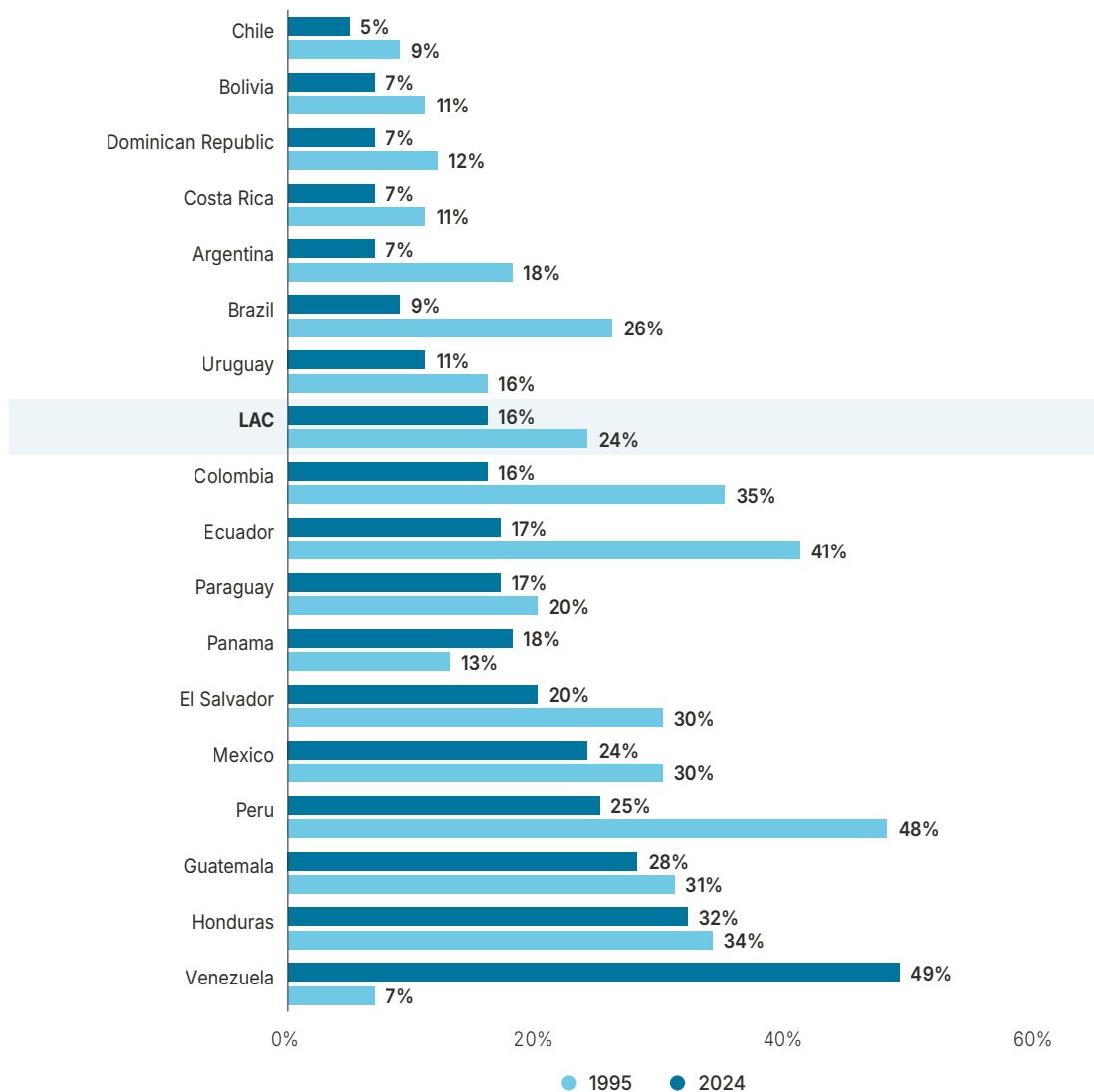
FIGURE 2.14 A EVOLUTION OF THE SHARE OF WORKERS EARNING BELOW THE POVERTY LINE (US\$6.85, 2017 PPP), LAC, 1995–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The regional average covers a sample of 16 Latin American and Caribbean countries, excluding Venezuela. Values are interpolated for missing years.

FIGURE 2.14 B SHARE OF WORKERS EARNING BELOW THE POVERTY LINE (US\$6.85, 2017 PPP) BY COUNTRY, 1995 AND 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The regional average covers a sample of 16 Latin American and Caribbean countries, excluding Venezuela. The latest available data for Venezuela are from 2021. The earliest available data for Colombia, Ecuador, and Guatemala are from 2000; Peru and Chile take values from 1997 and 1996, respectively.

Overall, despite some improvements, there are two concerning issues regarding labor income in the region. First, labor income generally remains low, with a high percentage of the working population still not earning enough to avoid poverty. Second, the fact that labor income growth has stagnated in recent years suggests that, in the absence of policy changes, significant improvements are unlikely. In Chapter 3, we will argue that low labor income levels are mainly a product of low productivity, but also, at times, the result of workers not receiving the full share of the value they generate. This will guide our policy recommendations in Chapter 8 to improve both worker productivity and the share of surplus that workers receive.

Going beyond labor income, the reader may have observed that improvements and setbacks in most labor market outcomes have been closely linked to overall economic performance. Between 1995 and the early 2000s, repeated economic crises led to higher unemployment and underemployment, stagnant or even declining real labor income, and rising labor poverty. Conversely, these indicators improved during periods of economic recovery. Indeed, much of the progress in labor market outcomes occurred during the commodity boom, when regional real GDP grew at an average annual rate of 4.5 percent between 2003 and 2013. This pattern underscores a fundamental point: sustained improvements in labor markets ultimately require stronger economic growth and higher productive capacity.

At the same time, cross-country comparisons reveal that growth alone is not sufficient. Some countries with strong economic performance did not achieve commensurate improvements in labor market outcomes. Panama, for example, experienced rapid economic growth over the past two decades, yet it was among the few countries where labor formality declined and the proportion of workers earning below the poverty line increased. This divergence highlights the role of institutions, labor market regulations, and social security systems in shaping how the gains from growth translate into job quality and worker protection. Producing more is necessary, but not enough, to deliver sustained improvements in labor market outcomes.

Finally, despite modest gains across most indicators, the pace of progress remains a source of concern. A central finding of this chapter is that key labor market indicators of the region in 2024 remain strikingly similar to their levels in 1995. Progress has been slow and insufficient, underscoring the urgency of addressing the structural and institutional constraints that continue to limit improvements in job quality across the region. This observation leads directly to the next key message emerging from the analysis of labor market trends in recent decades.

2.3 Progress Without Transformation: Little Has Changed in the Structure of Labor Markets

Although recent decades have brought measurable progress in several key labor market indicators in Latin America and the Caribbean, these improvements have not translated into a fundamental transformation of the region's labor markets. As this section documents, the basic structural features that shape employment opportunities and job quality in the region remain largely intact.

Employment continues to be heavily concentrated in small firms and in sectors characterized by low productivity. The organization of labor markets in the region remains complex and segmented. Informality continues to be a defining feature: despite advances in formal job creation, close to half of all workers still lack access to social security, and informal employment persists even within firms that are formally registered. This coexistence of formal and informal labor relations within the same firms reflects regulatory gaps and uneven enforcement, as well as firms' responses to high labor costs and low productivity. This will be addressed in more detail in Chapters 3 through 7.

At the same time, the composition of employment by labor relationship has shown remarkable stability over time. Wage employment remains the predominant form of work, but self-employment continues to play a much larger role than in advanced economies, often serving as a buffer in periods of weak labor demand rather than as a pathway to entrepreneurship and growth. Job stability also remains limited: compared with high-income countries, workers in the region experience more frequent transitions between jobs and recurrent movements into and out of formality, contributing to income volatility and limited accumulation of social security entitlements.

Finally, labor market outcomes in the region remain highly unequal across population groups. Differences by sex, race, age, education level, and place of residence continue to shape access to quality jobs, earnings, and social security. These persistent disparities underscore that, despite aggregate improvements, the benefits of labor market progress have been unevenly distributed, reinforcing long-standing patterns of inequality within and across countries in the region.

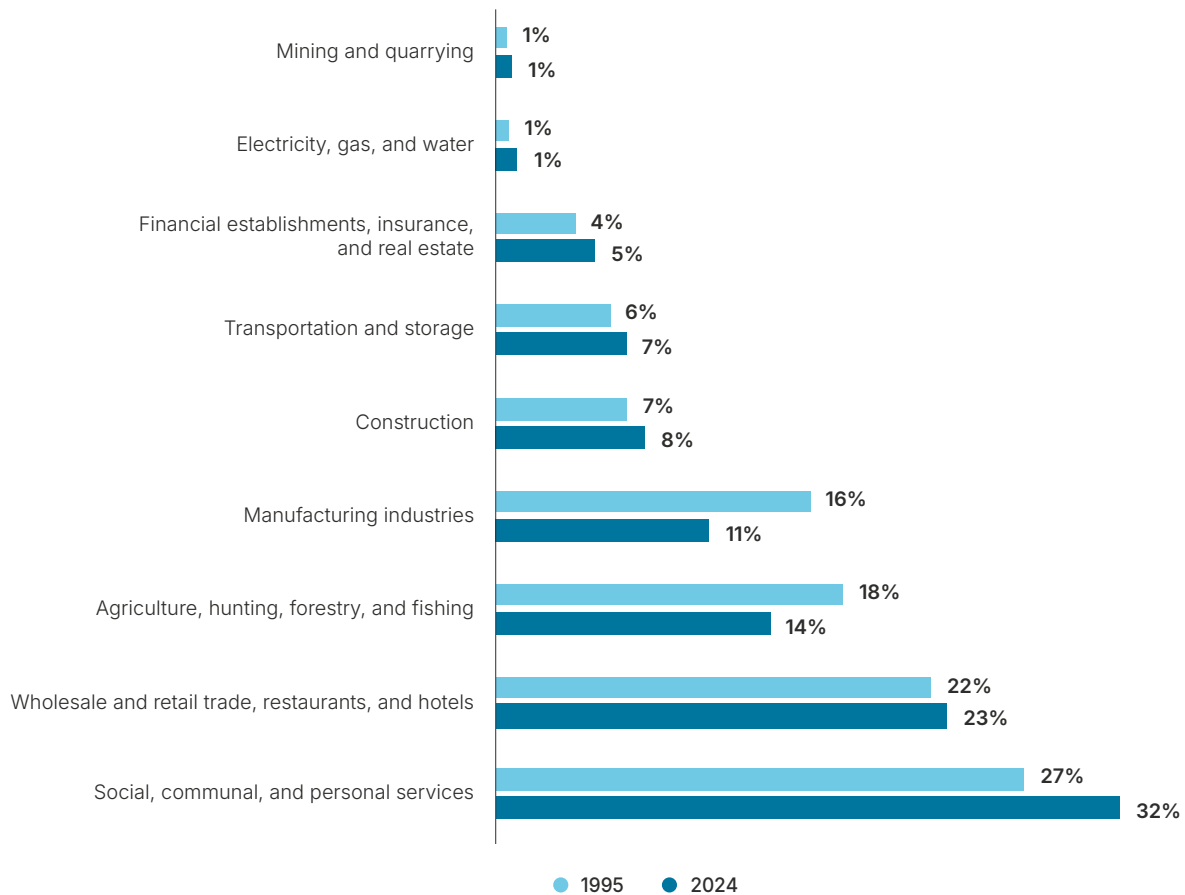
2.3.1 Low-Productivity Sectors and Small Firms Concentrate Most Workers

Countries in Latin America and the Caribbean experienced a pronounced shift in employment away from agriculture and manufacturing and toward services over the past thirty years, although employment remains highly concentrated in low-productivity sectors. As Figure 2.15 shows, agricultural employment fell from 18 percent in 1995 to 14 percent in 2024—most sharply in countries with large primary sectors such as Paraguay, Brazil, Peru, and Bolivia—while rural employment dropped from 38.6 to 26.6 percent over the same period.⁵ Industrial employment also declined, with manufacturing's share falling from 16 to 11 percent, underscoring the region's "premature deindustrialization," as globalization and labor-saving technologies reshape production (Rodrik 2016). In contrast, the service sector has continued to expand, increasing its share of total employment from 55 to 65 percent, driven primarily by growth in social, communal, and personal services.

This trend, however, masks substantial cross-country heterogeneity, as Figure 2.16 shows. Venezuela, Honduras, Costa Rica, Bolivia, and El Salvador expanded the share of workers in services by at least 15 percentage points between 1995 and 2024, while Southern Cone countries such as Chile, Argentina, and Uruguay increased their share by 5 percentage points or less. Overall, labor markets in the region have become increasingly urban and service-oriented, but this structural transition has occurred at significantly lower income levels than those observed in earlier industrializing economies.

5. In specific years, household surveys covered only urban areas. This estimate excludes Argentina for all years and uses the earliest available year for Ecuador (2000) and Uruguay (2006).

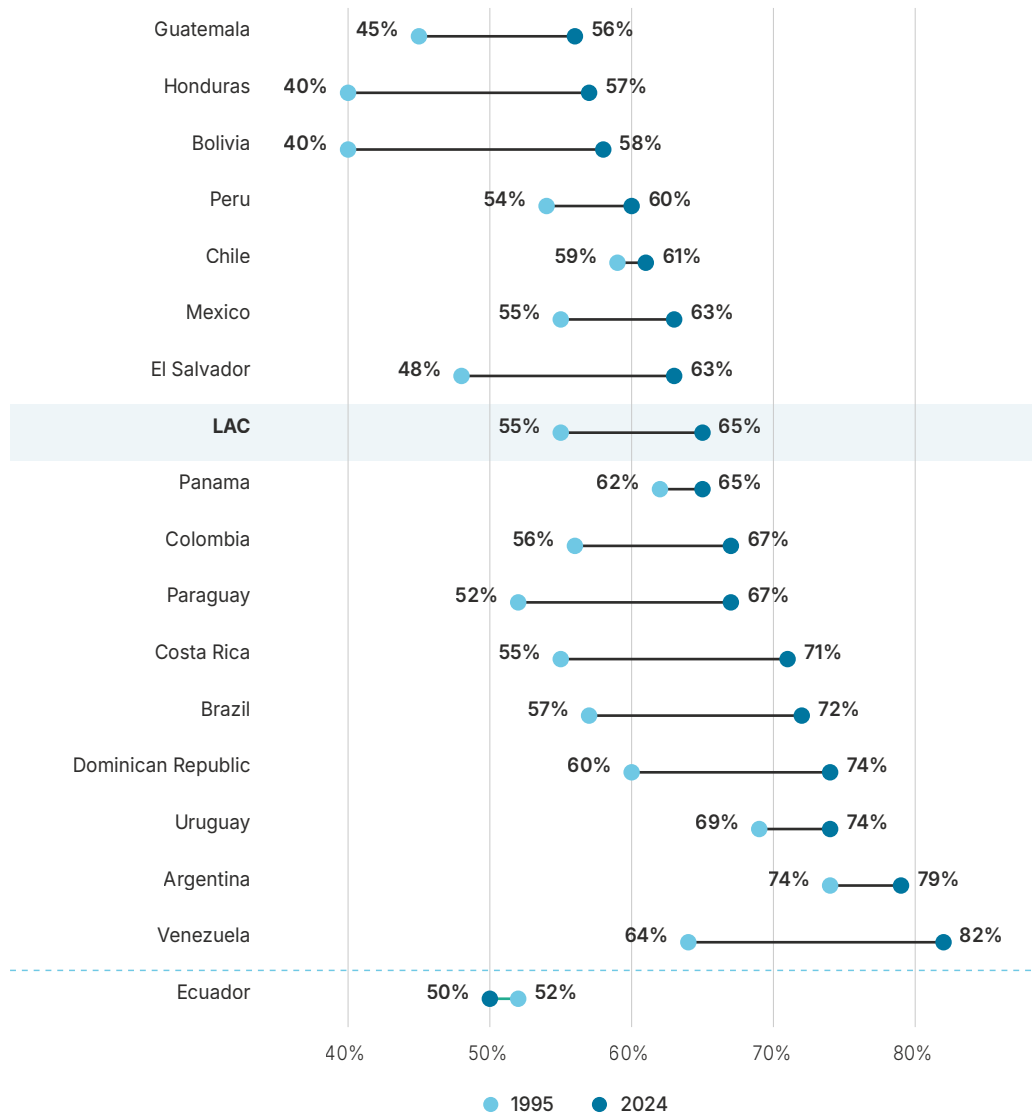
FIGURE 2.15 SHARE OF WORKERS BY INDUSTRY (LAC-15), 1995 AND 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 15 Latin American and Caribbean countries.

Note: Agriculture includes hunting, forestry, and fishing; public utilities refer to electricity, gas, and water. Earliest data availability varies by country: 1996 for Chile, Mexico, and Bolivia; 1997 for Peru; 2000 for Ecuador and Guatemala; and 2004 for Paraguay.

FIGURE 2.16 SHARE OF WORKERS IN THE SERVICE SECTOR BY COUNTRY, 1995 AND 2024

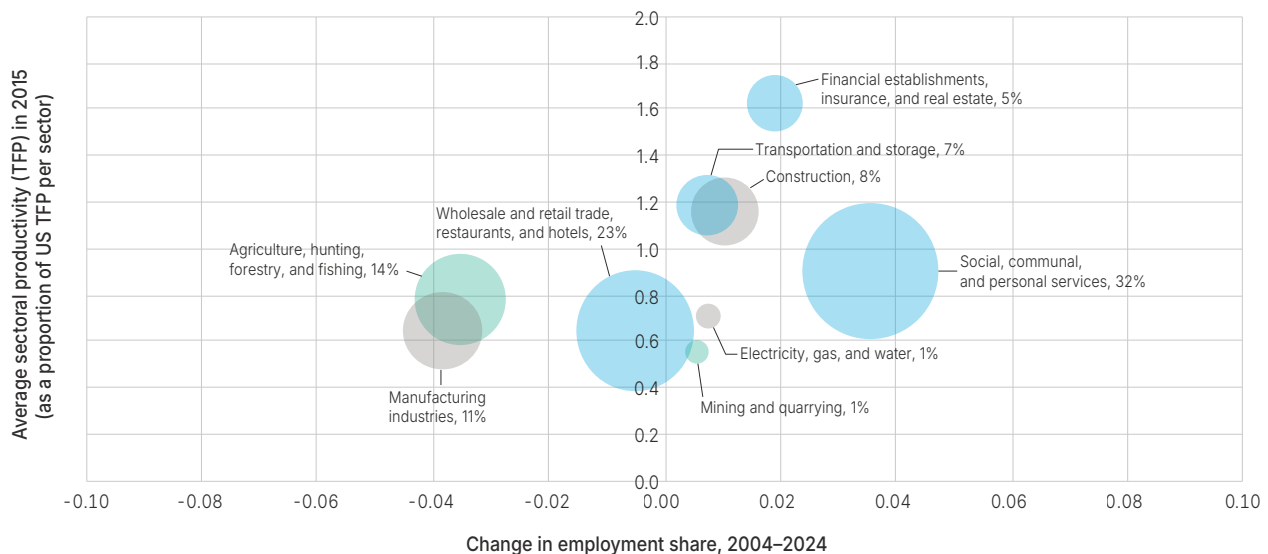


Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 15 Latin American and Caribbean countries.

Note: In green, the country where the share fell between 1995 and 2024.

The largest—and fastest-growing—sectors in the region are not those with the highest levels of total productivity. Figure 2.17 illustrates changes in the sectoral composition of employment between 2004 and 2024, alongside relative productivity levels benchmarked to the United States. While finance, insurance, real estate, and business services, as well as transportation and storage rank among the most productive service industries in Latin America and the Caribbean, they employ only about 5 and 7 percent of the workforce, respectively, and have expanded their employment shares by only about 1 percentage point on average over the past two decades.⁶ By contrast, the largest and fastest-growing sector since 2004 has been social, communal, and personal services, a sector with substantially lower average productivity relative to the United States. In 2024, about 40 percent of workers in this sector were employed in the public sector; however, growth has not been confined to public employment. The private component of this sector has also expanded markedly, with its share of private sector employment rising from 19 percent in 2004 to 24 percent in 2024.

FIGURE 2.17 WORKFORCE COMPOSITION: INDUSTRY GROWTH VS. PRODUCTIVITY (LAC-15)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 15 Latin American and Caribbean countries.

Note: Bubble size indicates the share of workers in 2024. Agriculture includes hunting, forestry, and fishing; public utilities refer to electricity, gas, and water. Average sectoral productivity is based on total factor productivity (TFP) estimates for eight Latin American economies—Chile, Colombia, Costa Rica, El Salvador, Honduras, Mexico, Peru, and the Dominican Republic—relative to US TFP levels (Gu and Hofman 2021).

6. Even lower when considering only private sector workers (around 0.8 percentage points).

Employment remains heavily concentrated in small, low-productivity firms and in self-employment—far more than in advanced economies—thereby constraining aggregate productivity. This pattern has shown little improvement over the past three decades. Using household surveys that collect information on firm size from workers, Figure 2.18 documents the evolution of employment by firm size across 12 Latin American and Caribbean countries. In 2024, nearly half of all workers in the region—46 percent—were either self-employed or employed in microenterprises with one to five workers; when unpaid workers in small family businesses are included, this share rises to 50 percent.

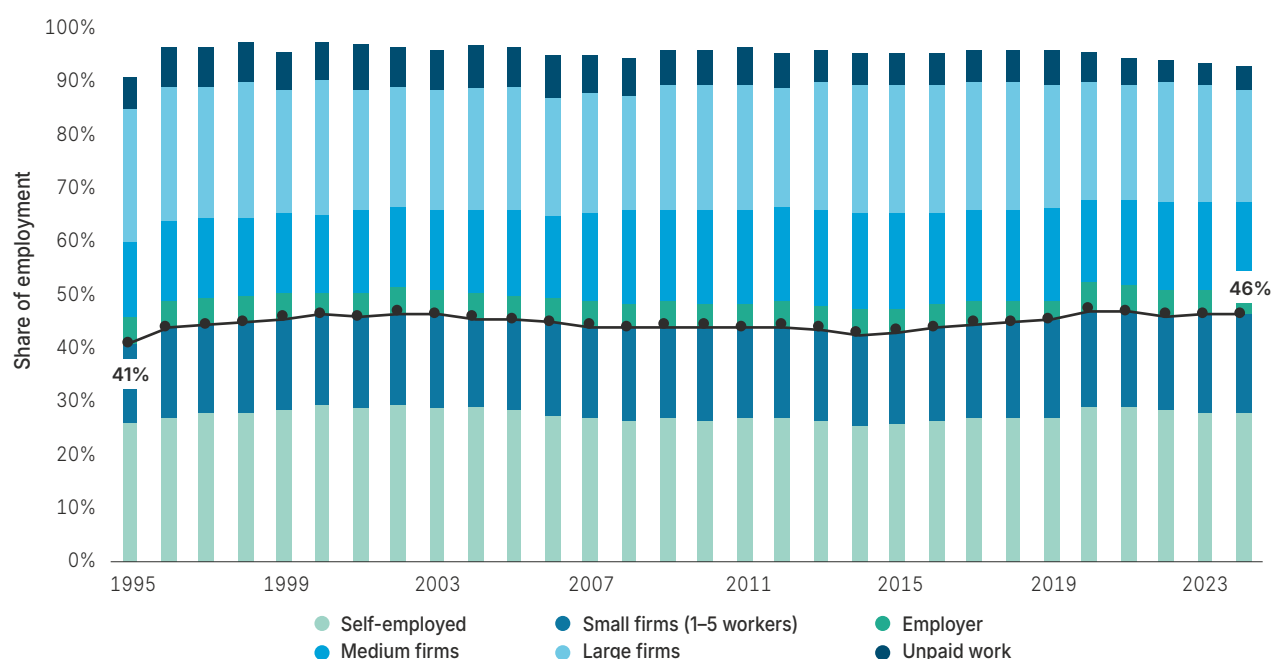
These estimates are consistent with recent findings based on employment surveys for 45 advanced and Latin American economies (Eslava et al. 2023). The concentration of employment in small firms in Latin America and the Caribbean is substantially higher than in more productive economies. For instance, only 7 percent of workers in the United States and 9 percent in high-income European countries are self-employed, compared with roughly one-third of workers in the region. Conversely, 61 percent of US workers and 43 percent of workers in high-income European countries are employed in large firms with more than 50 workers—shares that are three times and twice as large, respectively, as the regional average of 21 percent.

Importantly, the prevalence of self-employment and microenterprises in Latin America and the Caribbean cannot be attributed solely to differences in productive structure, as these gaps persist even within narrowly defined sectors (Eslava et al. 2023). Instead, the region exhibits an extreme concentration of employment in microfirms—and, to a lesser extent, in large firms—alongside a strikingly limited presence of medium-sized firms, a phenomenon often described as the “missing middle.” In 2024, only 16 percent of workers in the region were employed in medium-sized firms, one-third the combined share of self-employed workers and those in small firms, and below the 21 percent employed in large firms.

This employment distribution matters because smaller firms tend to be significantly less productive. Allocating a disproportionate share of labor to low-productivity firms reduces aggregate productivity and slows economic growth (Hsieh and Klenow 2009; Busso, Madrigal, and Pagés 2013; Alviarez et al. 2025). Moreover, the region has made little progress over the past two decades in reallocating workers toward more productive medium-sized and large firms. In fact, the situation has deteriorated. Over the past two decades, the share of workers employed in large firms with more than 50 employees decreased from 24 percent in 2004 to 21 percent in 2024. Conversely, over the same period, the share of workers in self-employment or small firms remained unchanged at 46 percent, declining to a low of 42 percent in 2014 before increasing again to 46 percent in 2024. Figure 2.19 shows that Bolivia,

Guatemala, Ecuador, and Peru exhibit the highest concentration of workers in small firms or independent work, at more than 50 percent, while Costa Rica and Uruguay show the lowest, at around 36 percent of total workers. Notably, the countries with the lowest levels of real labor income per worker in Figure 2.13 have the highest concentration of independent work and small businesses, while Costa Rica and Uruguay are among those with the highest levels of labor income per worker.

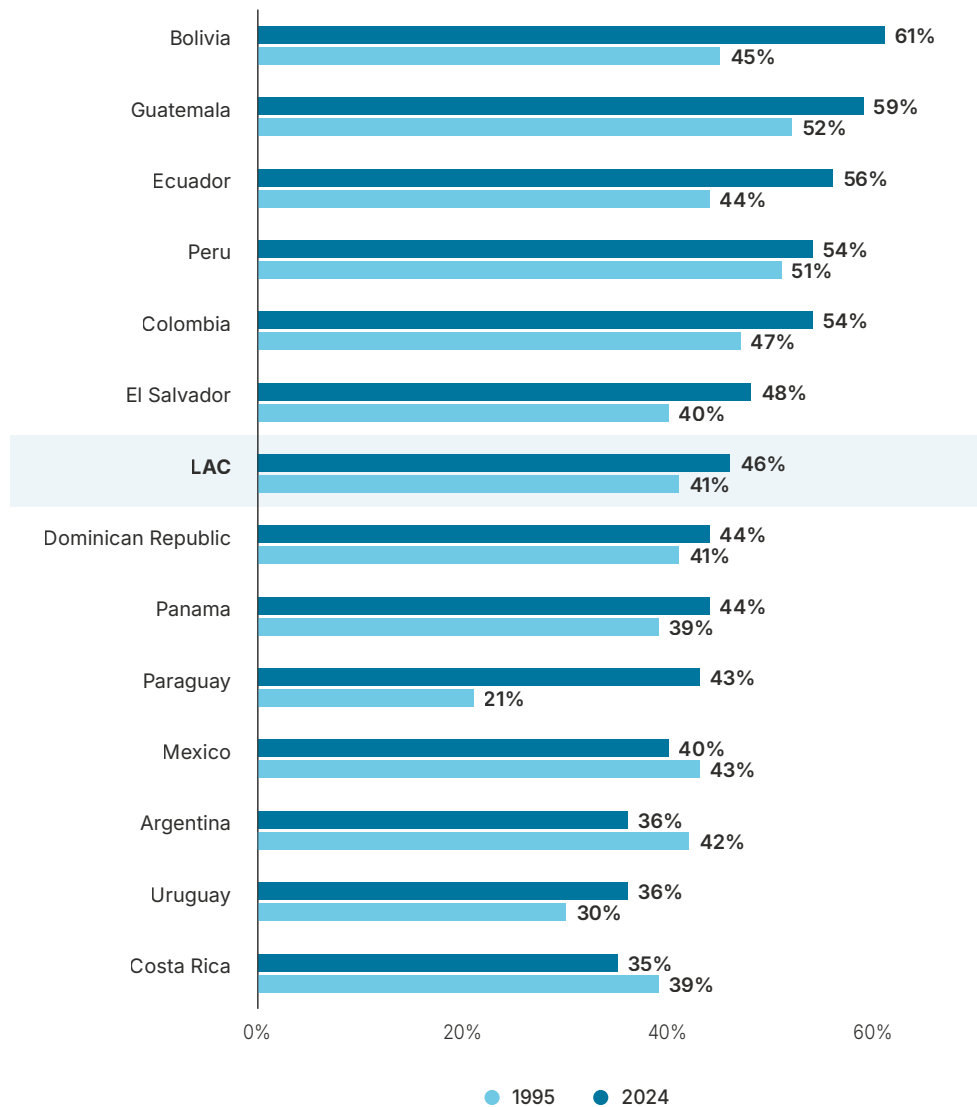
FIGURE 2.18 EVOLUTION OF EMPLOYMENT DISTRIBUTION BY FIRM SIZE (LAC-12), 1995–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 12 Latin American and Caribbean countries with comparable data.

Note: Firm categories are small = 1–5 workers, medium = 6–50 workers, large = more than 50 workers. Values are extrapolated for missing years. In Argentina, El Salvador, the Dominican Republic, and Uruguay, the definition of large firms differed before 2003, when the upper category included firms with 10–49 workers.

FIGURE 2.19 SHARE OF WORKERS IN SELF-EMPLOYMENT AND SMALL FIRMS BY COUNTRY, 1995 AND 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 12 Latin American and Caribbean countries with comparable data.

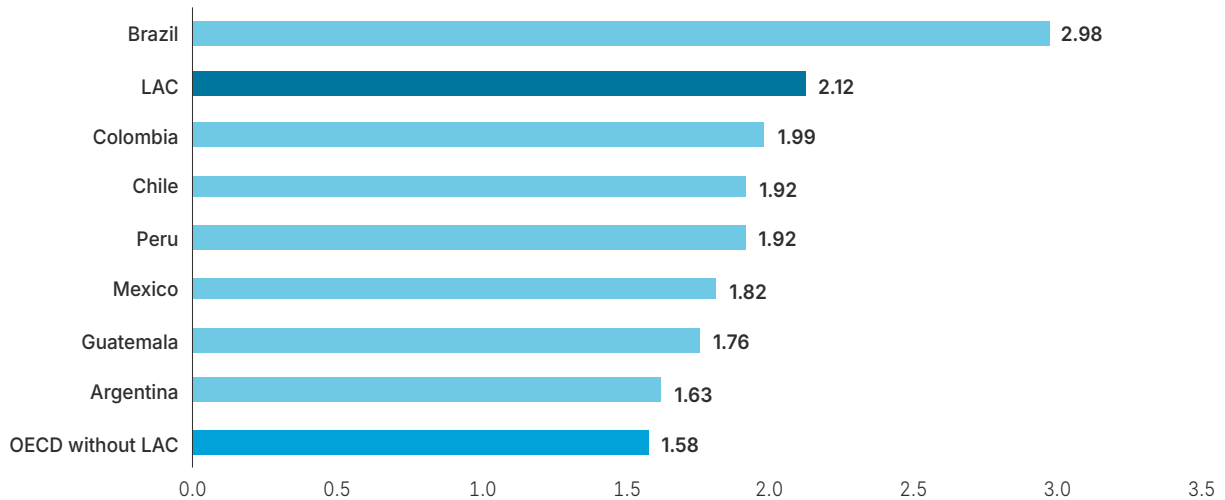
Note: Values are extrapolated for missing years. In Argentina, El Salvador, the Dominican Republic, and Uruguay, the definition of large firms differed before 2003, when the upper category included firms with 10–49 workers.

High-productivity firms exist in the region. Unfortunately, however, aggregate productivity is hampered by the fact that a large share of economies' capital and labor is employed in firms and economic sectors with low levels of productivity. Figure 2.20 presents estimates of productivity dispersion, that is, the difference in productivity between low- and high-productivity firms. In particular, the figure shows that, after accounting for differences in the levels of inputs used, such as labor and capital, a firm in Latin America and the Caribbean at the 75th percentile of the productivity distribution is two times more productive than a firm at the 25th percentile. The corresponding figure for OECD countries, excluding those in the region, is 1.6. In other words, productivity dispersion is high in the region.

Many firms in the region operate with extremely high levels of productivity, employing the most modern technologies available, but at the same time, something allows low-productivity firms, which tend to be small, to coexist with high-productivity firms. As of 2025, 61 percent of formal firms in the region compete with unregistered or informal firms, compared with 43 percent in upper-middle-income countries and 27 percent in high-income countries.⁷ In this sense, reallocating resources—both labor and capital—from low-productivity firms to high-productivity firms would generate a higher gain in aggregate productivity in Latin America and the Caribbean than in developed countries.

7. World Bank Enterprise Surveys for 2025 or the latest available data.

FIGURE 2.20 DISPERSION OF TOTAL FACTOR PRODUCTIVITY (TFP): RATIO OF THE 75TH TO THE 25TH PERCENTILE



Source: Authors' calculations, based on World Bank Enterprise Surveys (WBES).

Note: The comparison group comprises Belgium, Denmark, France, Germany, Italy, and Sweden.

2.3.2 The Structure of the Labor Market in Latin America and the Caribbean Is Extremely Complex

The previous section examined how workers are distributed across economic sectors and firm sizes. However, the complexity of the labor market extends well beyond these dimensions. Workers are also differentiated by whether they are employed in the public or private sector, in registered or unregistered firms, and by the type of contract and employment relationship they hold—dependent or independent—among other factors. Understanding these multiple layers of organization and how they evolve is essential for analyzing the labor market regulations discussed in the following chapters. It also helps clarify that the boundaries between labor and capital are sometimes blurred (see Box 2.1), making it difficult to draw clear-cut distinctions between policies that are “pro-worker” and those that are “pro-firm.”

BOX 2.1 SELF-EMPLOYED WORKERS: WHERE THE DIVISION BETWEEN LABOR AND CAPITAL BLURS

The distinction between wage employment and independent work is increasingly contested in both academic and legal debates, particularly when assessing labor and capital shares in the economy. For the purposes of this chapter, wage employment is defined as work performed under explicit or implicit contracts in which remuneration is not directly tied to the profits of the enterprise. This includes permanent, temporary, and casual employees, whether paid in cash or in kind, and regardless of whether a written contract exists. In Latin America, wage employment does not necessarily imply formal contractual arrangements: 39 percent of wage workers report that they do not have a written contract, reflecting the prevalence of nonstandard employment arrangements.

The complexity of this distinction is further amplified in the context of family-owned firms, which are widespread across the region. These enterprises range from small businesses to some of the world's largest corporations and account for approximately 60 percent of gross national product in Latin America (IFC 2018). Other estimates suggest that between 65 and 98 percent of all firms in the region are family businesses (Kelley, Gartner, and Allen 2020). In small firms in particular, family ownership blurs the boundary between labor and capital, as workers and owners often belong to the same household. Evidence from the *GEM 2020 Family Entrepreneurship Report* indicates that more than 75 percent of entrepreneurs in Latin America involve family members in their start-ups—a share similar to that in other regions. Among the 48 countries surveyed, the most common form of family entrepreneurship is co-management without co-ownership, and 57 percent of entrepreneurs expect family members to make up the majority of their workforce in the future.

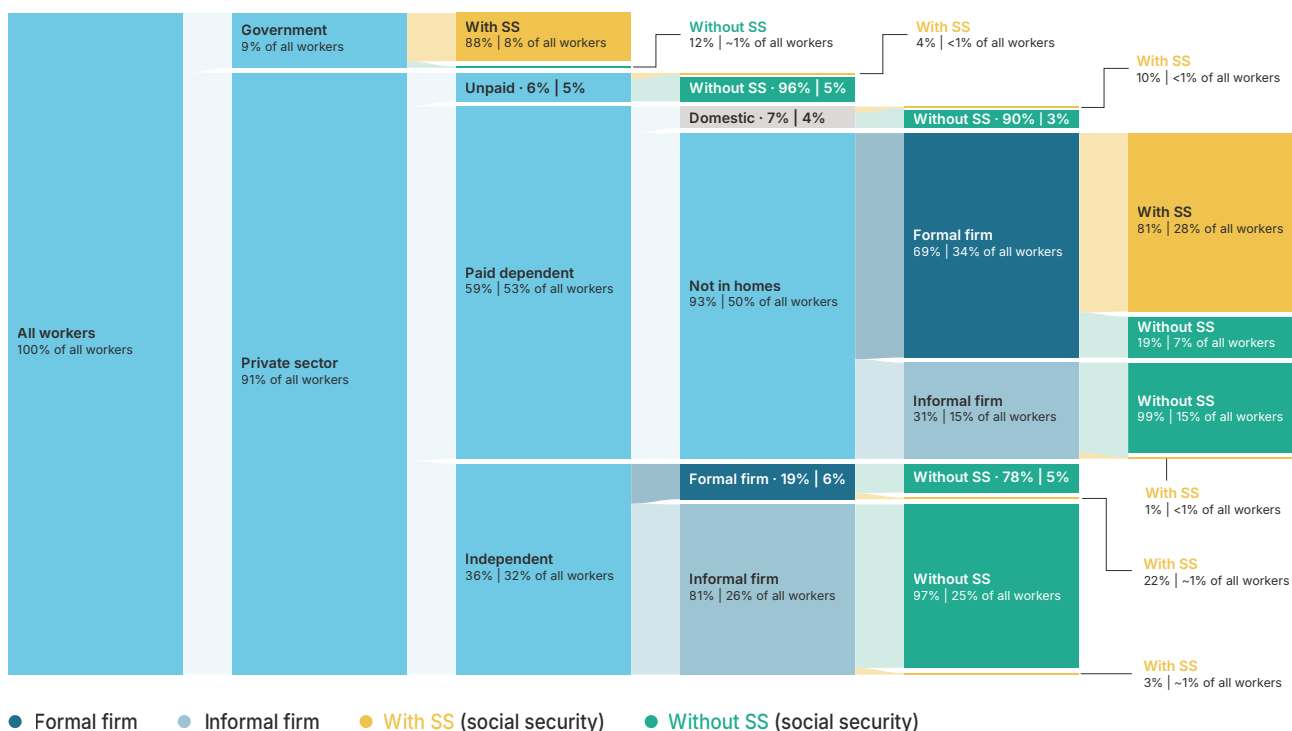
Similarly, self-employment further complicates the measurement of labor and capital shares. Independent workers often earn income both from their labor and from returns to the assets they control, making it difficult to distinguish between compensation for work and profits from capital. New technologies, including platform-based work, have intensified this challenge by creating arrangements that combine aspects of wage and independent work, further blurring traditional boundaries.

Figure 2.21 offers a glimpse of this complexity, aggregating data from a sample of 10 countries with household surveys that allow for the detailed characterization included in the figure. Jobs are divided into two very broad categories: public sector and private sector. The public sector encompasses roughly 9 percent of employment, while the private sector accounts for the

2 Three Decades of Modest Progress and Emerging Challenges in Labor Markets

remaining 91 percent. Within the private sector, there are also enormous differences among types of employment. For example, 6 percent of private sector jobs, or 5 percent of total jobs, are unpaid, while 36 percent of private sector jobs, or 32 percent of jobs overall, are held by independent workers. Independent workers include both own-account workers without employees and employers. The segment of dependent workers in the private sector—that is, employees who work for employers—constitutes 59 percent of employment in the private sector, or 53 percent of total employment. Of this segment, a noteworthy category is that of people who work in homes rather than firms, who constitute 7 percent of private sector employment and 4 percent of total employment.

FIGURE 2.21 CHARACTERIZATION OF THE LABOR MARKET IN LATIN AMERICA AND THE CARIBBEAN, CIRCA 2023 (SAMPLE OF 10 COUNTRIES)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: Regional aggregates are based on a population-weighted average of 10 countries (Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guyana, Mexico, Paraguay, Peru, and Uruguay) for 2023 or the latest year available. These countries were selected because their surveys allow the identification of social security and tax information for dependent and independent workers.

For both independent workers and dependent workers in private sector firms, excluding homes, we further allocate workers into formal or informal enterprises, essentially based on whether the enterprise is registered for tax purposes or in the case of independent workers, if they are registered for tax purposes or keep bookkeeping for tax purposes. Regarding dependent workers, the majority, 69 percent, are in formal enterprises, although a substantial minority, 31 percent, are in informal enterprises. One level below in the figure, where we address the percentage of workers with social security, we see that most dependent workers in formal enterprises, 81 percent, have social security, while very few dependent workers in informal enterprises, 1 percent, have social security. Among independent workers, the majority (81 percent) own informal enterprises, and most of these owners lack social security coverage. Only 19 percent own enterprises that are formal for tax purposes, and of these, just 22 percent (about 4 percent of all independent workers) have social security. As we will discuss in more detail in Chapter 5, this latter figure varies substantially across countries. In countries in which social security is voluntary for independent workers, social security coverage even among workers with formal enterprises is close to zero.

Only about 28 percent of workers in the region hold what could be called a "standard" job: wage employment in a private firm with social security.

When one thinks about jobs, the first thing that comes to mind is an employee working in a private sector firm and earning a wage. Interestingly, this "traditional" group of workers constitutes only 50 percent of total employment. To the extent that much of the social security system has been designed to serve this group, we begin to see that a social protection system that depends too much on these types of work relationships will have problems. And we have not even begun to address the issue of formality, either of the workplace or of the worker.

If the reader had trouble following the complexity of this figure, the important point is that the design of social security and social protection more generally needs to recognize that the labor market is extremely complex. It is important to recognize that around 5 percent of total workers are unpaid, usually in family businesses, and are essentially completely uncovered by traditional social security. Another 4 percent of workers, mainly women, work in homes and are largely excluded from social security, either by law or by lack of effective enforcement. Independent workers, who account for 32 percent of the total workforce in this sample of countries, are also largely excluded from social security, including many of those who own formal enterprises. Overall, only 28 percent of jobs are what we probably have in mind when we think about "standard" jobs, that is, wage employment in formal private sector enterprises, with social security benefits.

2.3.3 Persistent Employment Patterns: Wage Work Dominates, Self-Employment Remains High

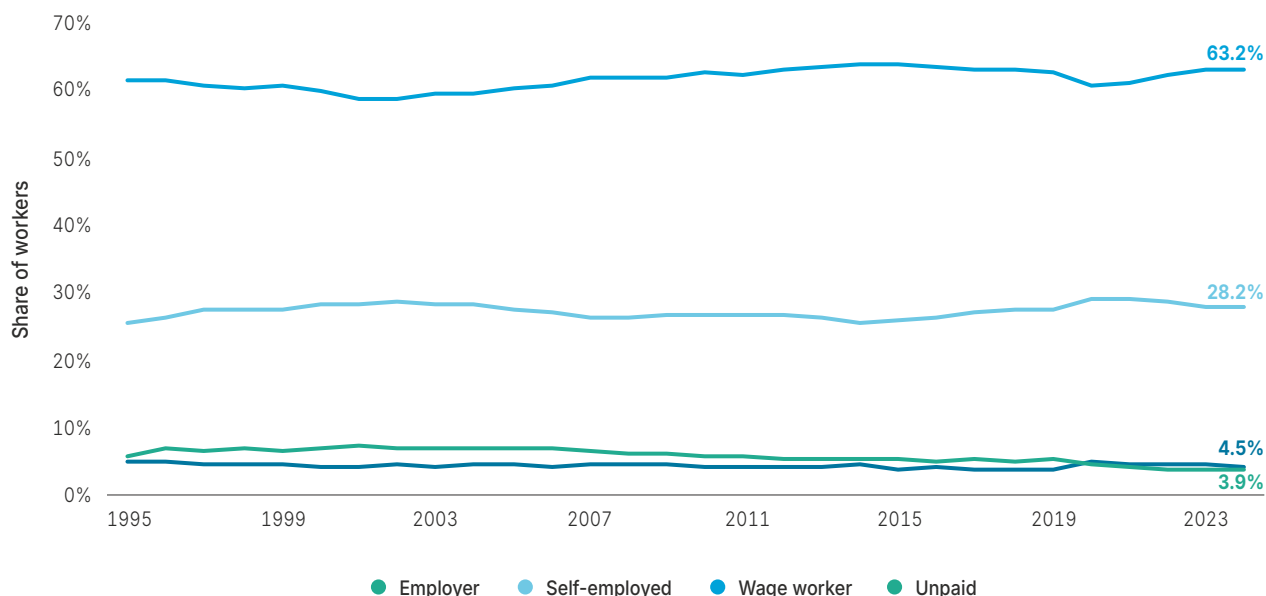
Wage work remains the dominant form of work. Figure 2.22 shows that around 63 percent of workers in the region are wage earners, a share that has remained relatively stable over the past two decades and remains well below the OECD average, where approximately 85 percent of workers are in dependent employment. Except in Bolivia, wage employment is the dominant form of work across the region, although substantial cross-country disparities persist (see Figure 2.23). Costa Rica, Mexico, Argentina, Chile, and Uruguay report wage employment shares exceeding 70 percent, approaching the OECD benchmark. By contrast, Peru, Colombia, and Bolivia exhibit much lower levels, with wage employment accounting for around 50 percent or less of total employment. We will return to this issue in Chapter 9 when discussing policies, but nothing in the recent evolution of employment suggests that the regulation of wage work will become unimportant anytime soon. In fact, rather than preparing for a “future of work” in which wage work is disappearing, we argue that policymakers ought to correct distortions that impede the creation of more wage jobs.

Self-employment in the region functions largely as a buffer against labor market shocks rather than a pathway to productivity growth.

Self-employment in Latin America and the Caribbean—already high by international standards, as discussed in the section on firm size—has continued to increase. The share of self-employed workers rose from 25 percent in 2004 to 28 percent in 2024, partly reflecting a decline in the proportion of unpaid workers and employers (Figure 2.22). In Bolivia, Colombia, Venezuela, Peru, the Dominican Republic, and Ecuador, self-employment accounts for more than one-third of total employment. This high prevalence of self-employment appears excessive, as long-standing evidence indicates that self-employment in the region functions primarily as a means of subsistence, closely associated with poverty, economic stagnation, and limited economic opportunities (Cáceres and Cáceres 2017), rather than as a driver of entrepreneurship, innovation, or technological change.

A cohort analysis provides no clear evidence that self-employment is rising among younger workers, who might be expected to be more inclined toward flexible work arrangements such as freelancing and platform-based employment (see Appendix 3). On the contrary, the baby boomer generation, comprising workers born between 1946 and 1964, consistently exhibits a higher propensity for independent work than younger cohorts at all ages. Taken together, these patterns suggest that “future of work” trends are unlikely to be the main drivers of either the recent increase or the persistently high levels of self-employment observed in the region.

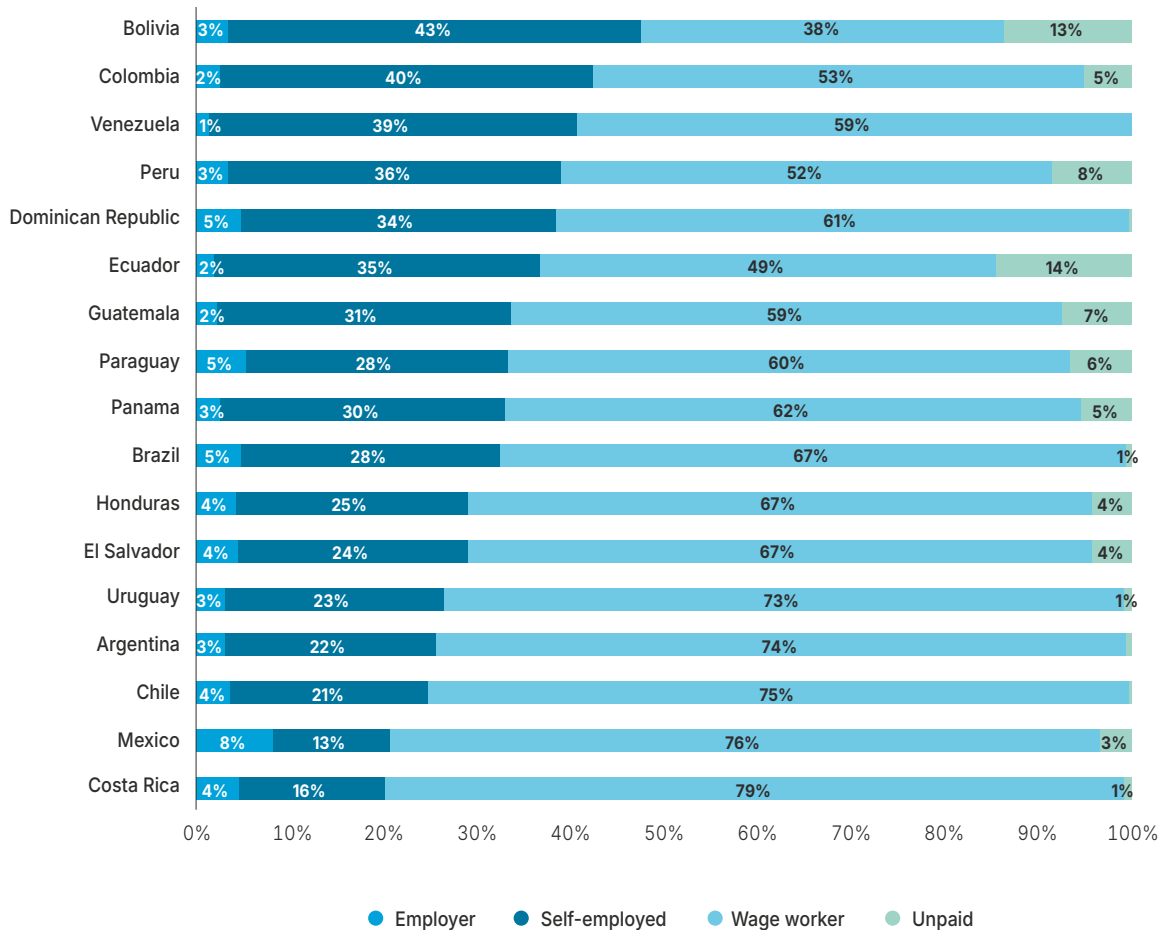
FIGURE 2.22 EVOLUTION OF WORK COMPOSITION BY LABOR RELATION (LAC-16), 1995–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 16 Latin American and Caribbean economies, excluding Venezuela.

Note: Values are interpolated for missing years. Independent workers include both self-employed workers and employers.

FIGURE 2.23 WORK COMPOSITION BY LABOR RELATION AND COUNTRY, 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

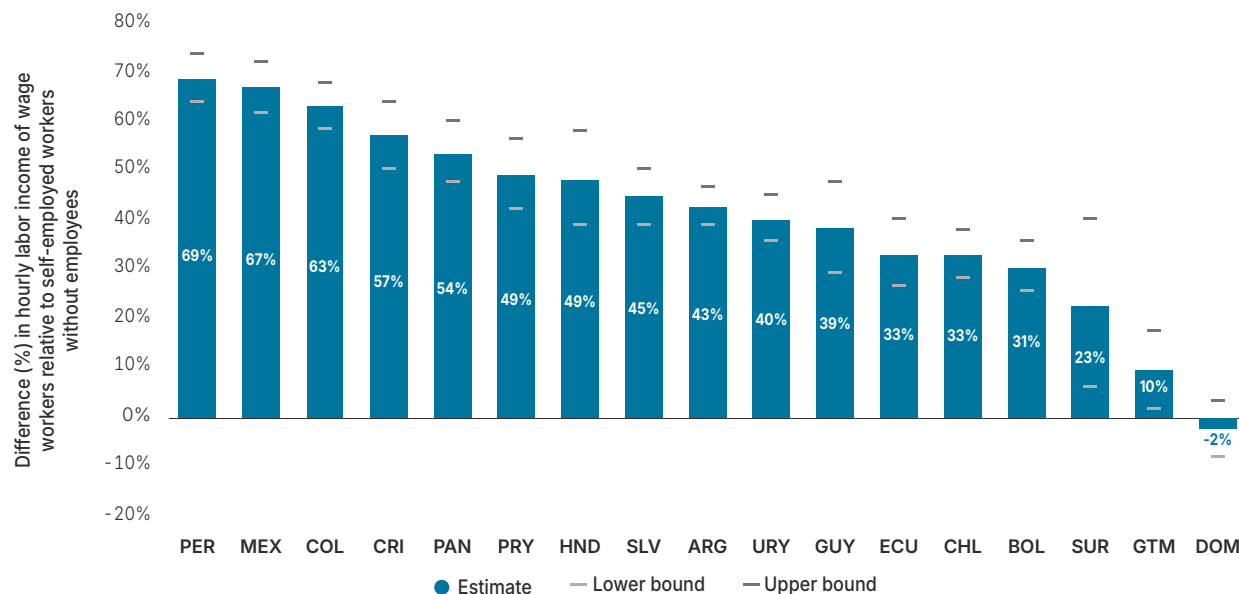
Instead, several findings support the view that high rates of self-employment in the region are associated with poverty, economic stagnation, and limited opportunities. First, using earnings as a proxy for productivity, wage employees earn on average 41 percent more than self-employed workers in their main occupation, even after controlling for sex, age, education, and sector of activity. In fact, in Peru, Mexico, and Colombia, wage workers earn, on average, more than 60 percent more per hour than self-employed workers (see Figure 2.24). Moreover, because a portion of self-employment income reflects returns to physical capital rather than labor, the true labor returns to self-employment are likely even lower relative to wage employment. Second, self-employed workers are 10 percent less likely to be employed in high-productivity sectors,⁸ again after accounting for individual characteristics. Within low-productivity sectors, earnings dispersion among the self-employed is very limited, indicating that most are concentrated in uniformly low-productivity activities.

Third, self-employment appears to be a matter of necessity rather than the result of having a business idea that could only be developed through one's own business. Fernández Mejía (2025) uses Colombian data and finds that self-employment enterprises created because the person has a business idea are 7 percent more productive than the typical small firm with wage employees. Unfortunately, only 14 percent of self-employed workers with a small business fall into this category. Instead, the majority—47 percent—of self-employed workers with small businesses cite necessity as the primary motivation for self-employment, and these businesses are 4 percent less productive than the typical small firm with wage employment. The remaining 39 percent of self-employed workers with small businesses state that they made this choice because of the flexibility afforded by self-employment. Fernández Mejía also finds that self-employment enterprises created for reasons of flexibility are 5 percent less productive than the typical small firm with wage employment. Overall, based both on the motivations people themselves report and on estimated productivity differences, roughly half of self-employment appears to involve cases in which people would seem to prefer wage employment and would likely be more productive in wage employment. To the extent that current public policies encourage this type of self-employment, finding alternatives is imperative, both for aggregate productivity and for the welfare of the people involved.

8. Sectors include mining; electricity, gas, and water supply; financial intermediation; and insurance, real estate, and business services.

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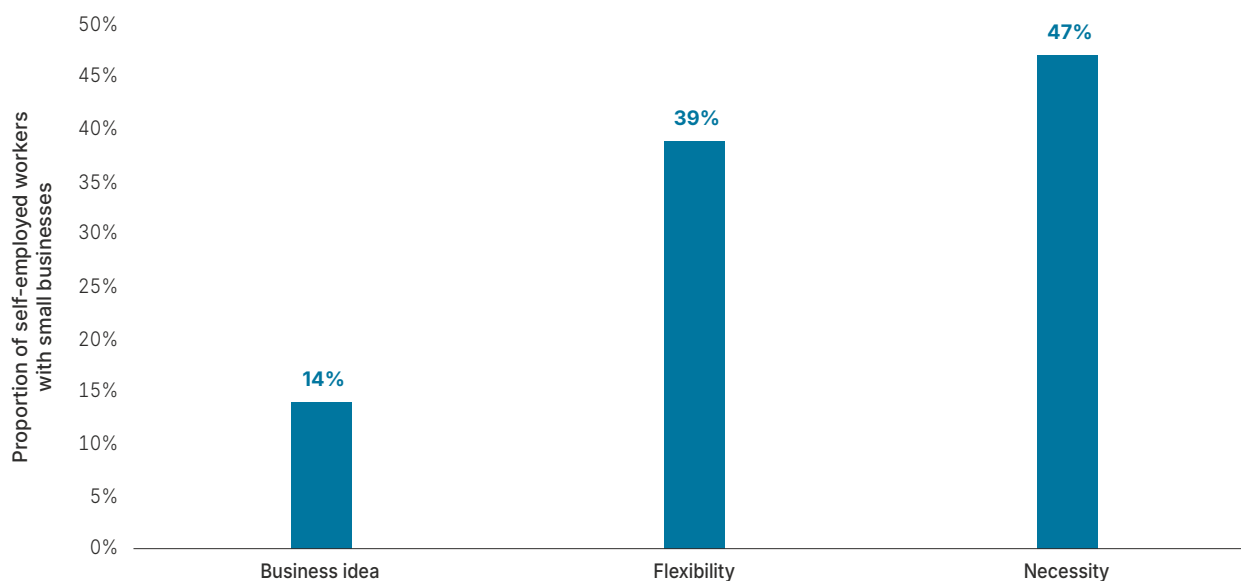
FIGURE 2.24 DIFFERENCE IN HOURLY LABOR INCOME: WAGE WORKERS VS. SELF-EMPLOYED



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: Results are based on a weighted ordinary least squares (OLS) regression of log hourly wages on age, education (linear and squared terms), sex, and industry fixed effects, circa 2023.

FIGURE 2.25 SELF-EMPLOYMENT IN COLOMBIA, BY MOTIVATION



Source: Fernández Mejía (2025).

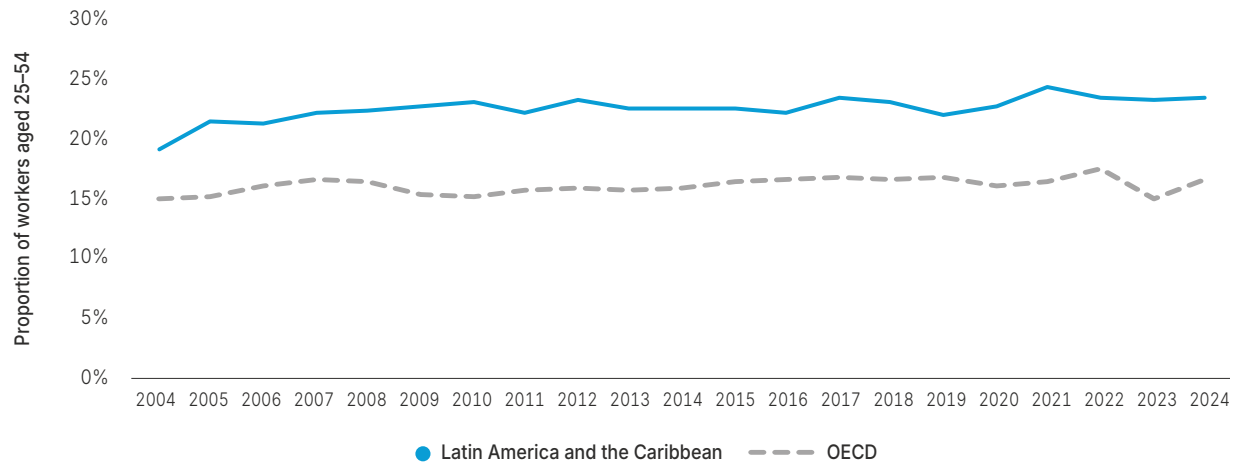
2.3.4 A Labor Market of Constant Transitions

Data on length of tenure in a firm have generally been used in the literature to describe the stability and security of jobs in the labor market, with longer worker tenure in a firm interpreted as greater security and shorter tenure as less security (Alaimo et al. 2015). The employment created in the region is very short-lived. Figure 2.26 shows that while 17 percent of workers in the OECD had one year or less in their current job in 2024, 23 percent of workers in Latin America and the Caribbean had one year or less of tenure. There are clear differences across countries, as shown in Figure 2.27. In Peru and Colombia, the share of prime-age workers with one year or less of tenure is more than twice as large as in the OECD.

One might expect these differences in tenure between Latin America and the Caribbean and OECD countries to reflect demographic composition, as the region has a larger share of young workers who are at earlier stages of their careers and therefore tend to exhibit shorter job tenure. But closer analysis shows that composition effects do not fully explain the difference between Latin America and the Caribbean and the OECD. While the region has a younger workforce than the OECD, the short-tenure trend remains even among younger populations. In 2024, 13 percent of people between 25 and 34 years of age in the OECD had less than one year of tenure, compared with 34 percent in the region. Part of this difference might be explained by the high prevalence of informal jobs, as formal jobs offer more stability. While formal employees in 2024 had a median tenure of 4.6 years, informal employees had a median tenure of 2.2 years.

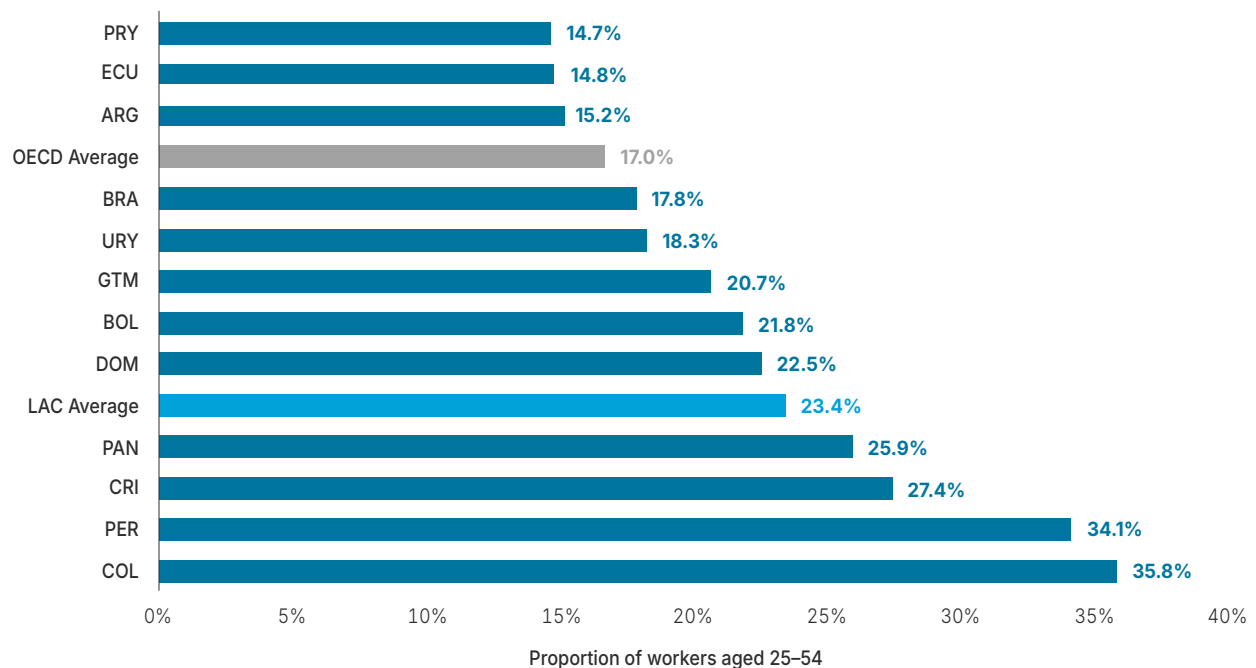
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FIGURE 2.26 EVOLUTION OF THE SHARE OF WORKERS AGED 25–54 WITH ONE YEAR OR LESS OF TENURE IN THEIR CURRENT JOB (LAC-12), 2004–2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean and OECD Employment and Labour Market Statistics; unweighted average of 12 Latin American and Caribbean countries.

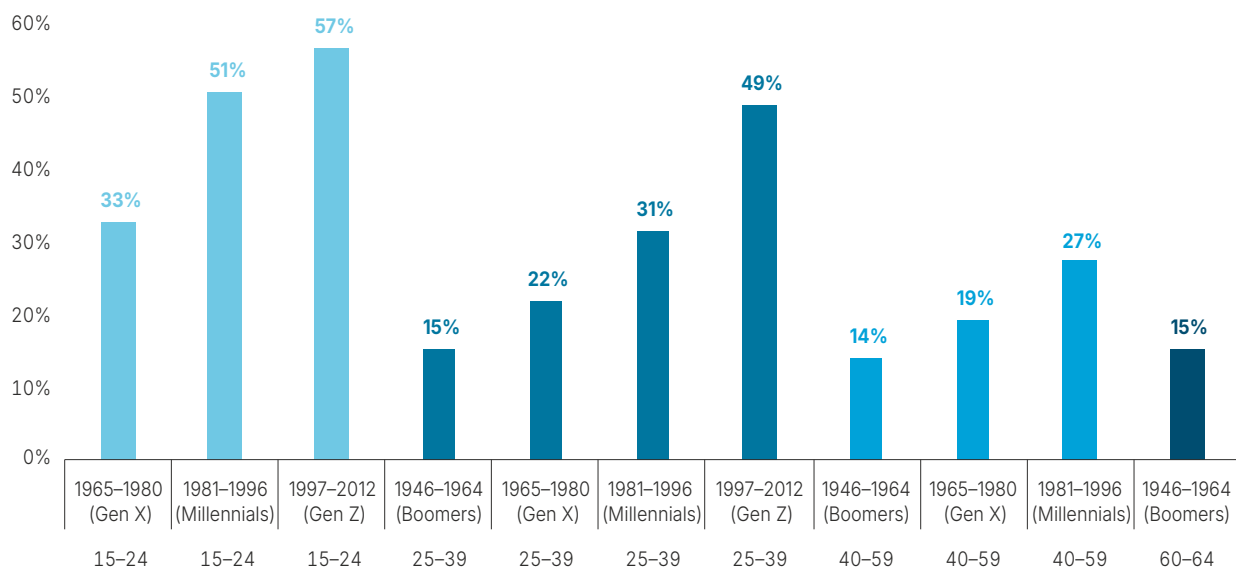
FIGURE 2.27 SHARE OF WORKERS AGED 25–54 WITH ONE YEAR OR LESS OF TENURE IN THEIR CURRENT JOB, CIRCA 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean and OECD Employment and Labour Market Statistics; unweighted average of 12 Latin American and Caribbean countries.

Figure 2.26 shows that the share of workers ages 25–54 in Latin America and the Caribbean with tenure of one year or less in their current job remained relatively stable between 2004 and 2024. But these averages can hide recent developments among younger generations; therefore, we complement this analysis with a cohort analysis. Figure 2.28 shows that, in general, younger generations tend to have lower tenure at all ages than older generations. Among workers ages 25–39, 31 percent of Millennials, those born between 1981 and 1996, and 49 percent of Generation Z, those born between 1997 and 2012, had one year or less in their current position, compared with 15 to 22 percent of workers in previous generations at that age. We therefore see some evidence that job instability is increasing over time.

FIGURE 2.28 WORKERS WITH ONE YEAR OR LESS OF TENURE, BY GENERATION



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

While the constant reallocation of workers is not per se a bad thing, as workers can transition to more productive jobs, evidence for the region indicates that these transitions are often into informal jobs or unemployment. Beccaria and Maurizio (2020) found that in six Latin American countries—Argentina, Brazil, Ecuador, Mexico, Paraguay, and Peru—50 to 70 percent of job exits were transitions to another job, often a precarious one. Transitions are more frequent among informal, low-skilled, and young workers, potentially hurting wage prospects in the

long run (Filho and Narita 2023). Higher-income workers, by contrast, experience longer and more stable spells of formal employment. Similarly, Albagli et al. (2021) find that almost half of all transitions in Chile occur “down the firm productivity ladder.”

Recent evidence for eight Latin American countries by Aristizabal-Ramirez, Santos, and Torres (2025) shows that displaced formal workers in high-unemployment countries typically enter unemployment, while in high-informality countries they move into informality. Informality spells are shorter where unemployment is high, whereas unemployment spells are shorter where informality is widespread. The observed trade-off between unemployment and informality is robust to controls and suggests that institutional features such as the rule of law, minimum wage enforcement, and social protection, which will be discussed in Chapters 4 and 5, play a role in shaping workers’ experience outside the formal sector.

These frequent transitions into and out of formal employment also pose significant challenges for labor and social security regulation. The prevalence of these transitions highlights an important distinction between formal workers and periods of formal employment: given repeated movements into and out of formality, the latter provides a more accurate characterization of workers’ attachment to the labor market. As a result, referring to “formal workers” can be misleading; instead, policymakers should focus on workers while they are formally employed. These transitions have important implications for social protection, affecting risk coverage, continuity and quality of health care, and the density of pension contributions. These aspects will be discussed in more detail in Chapter 5.

Another way to assess job stability is by examining the type of employment contracts workers hold. Indefinite, or open-ended, contracts typically provide greater job security and employment stability and are therefore a key dimension of job quality. Based on 2024 household survey data for nine Latin American and Caribbean countries, 43 percent of wage workers were employed under indefinite contracts, 18 percent under fixed-term contracts, and a striking 39 percent reported having no written contract at all—signaling *de facto* informality even within wage employment.⁹ Relative to 2004, and focusing on countries with comparable data, contract conditions have improved modestly. The share of wage workers without a written contract declined by an average of 12 percentage points, while the proportion holding indefinite contracts increased by 8 percentage points. At the same time, the share of workers with fixed-term contracts rose by about 4 percentage points, suggesting that some of the reduction in informality within wage employment has been accompanied by greater use of temporary arrangements rather than a full shift toward stable, open-ended employment.

9. Surveys usually classify workers as indefinite or temporary before recording the absence of a written contract.

Moreover, substantial cross-country differences persist and have remained largely stable over time (Table 2.1), pointing to the role of structural and institutional factors. In 2024, Peru exhibited the lowest prevalence of permanent contracts, with only 15 percent of wage workers holding an indefinite contract, reflecting weak enforcement and high levels of informality. By contrast, more than 75 percent of salaried workers in Argentina were employed under open-ended contracts, consistent with stronger labor institutions and higher compliance. Chapter 4 examines in greater detail the institutional arrangements that shape incentives for more permanent and stable forms of employment. A closer look at Table 2.1 indicates that the use of temporary contracts increased between 2004 and 2024 in five out of nine analyzed countries (Bolivia, Colombia, Guatemala, Paraguay, and Peru) and decreased only in Argentina, Mexico, and Panama. However, these aggregate trends may mask important generational dynamics, which merit further analysis.

TABLE 2.1 SALARIED WORKERS BY CONTRACT TYPE, 2004 VS. 2024

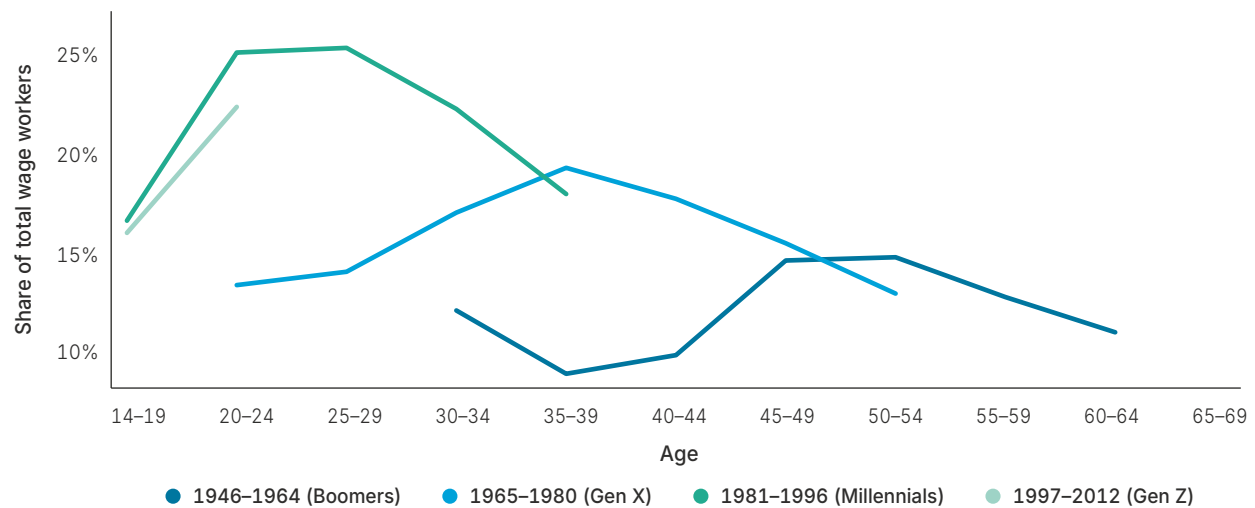
COUNTRY	CIRCA 2004			CIRCA 2024		
	INDEFINITE / PERMANENT	TEMPORARY / FIXED TERM	NO CONTRACT / VERBAL	INDEFINITE / PERMANENT	TEMPORARY / FIXED TERM	NO CONTRACT / VERBAL
Argentina	65%	16%	n/a	77%	9%	n/a
Panama	60%	19%	21%	65%	14%	20%
Colombia	37%	16%	43%	53%	18%	29%
Ecuador	n/a	n/a	n/a	47%	28%	25%
Mexico	39%	13%	55%	42%	11%	48%
Paraguay	25%	15%	60%	33%	23%	44%
Guatemala	27%	5%	68%	31%	8%	62%
Bolivia	20%	19%	62%	26%	27%	46%
Peru	9%	11%	80%	15%	37%	49%
Average ⁽¹⁾	35%	14%	51%	43%	18%	39%

Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The law recognizes a valid contract without a written instrument in Panama, Colombia, Ecuador, Bolivia, and Peru; however, in these countries survey instruments typically classify workers as indefinite or fixed-term before recording the absence of a written contract. In Argentina, contract type is proxied by job type (indefinite or temporary). The latest data are from 2019 for Bolivia and 2022 for Panama; the earliest data are from 2006 for Colombia, 2005 for Paraguay, and 2008 for Mexico. (1) The regional average excludes Ecuador owing to a lack of comparable data.

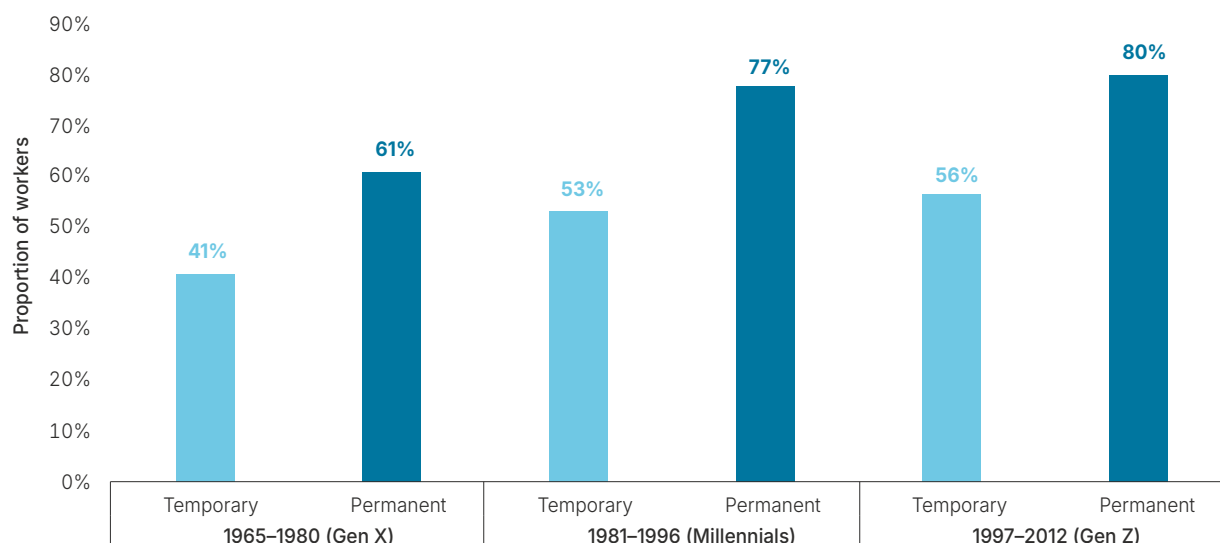
A cohort analysis based on household survey data indicates that temporary contracts are becoming increasingly common among younger cohorts of workers (Figure 2.29). While temporary contracts have traditionally been more prevalent among young workers—reflecting their frequent use as probationary arrangements for labor market entrants—today's young workers with temporary contracts are more likely than previous generations to have social security coverage (Figure 2.30).

FIGURE 2.29 SHARE OF WAGE WORKERS WITH TEMPORARY CONTRACT ARRANGEMENTS, BY COHORT (LAC-9)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean and data from nine Latin American and Caribbean countries (see Table 2.1).

FIGURE 2.30 SHARE OF WAGE WORKERS WITH SOCIAL SECURITY AT AGES 25–29, BY COHORT AND CONTRACT TYPE



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean and data from nine Latin American and Caribbean countries (see Table 2.1).

2.3.5 Labor Market Inequality Across Groups Remains Widespread

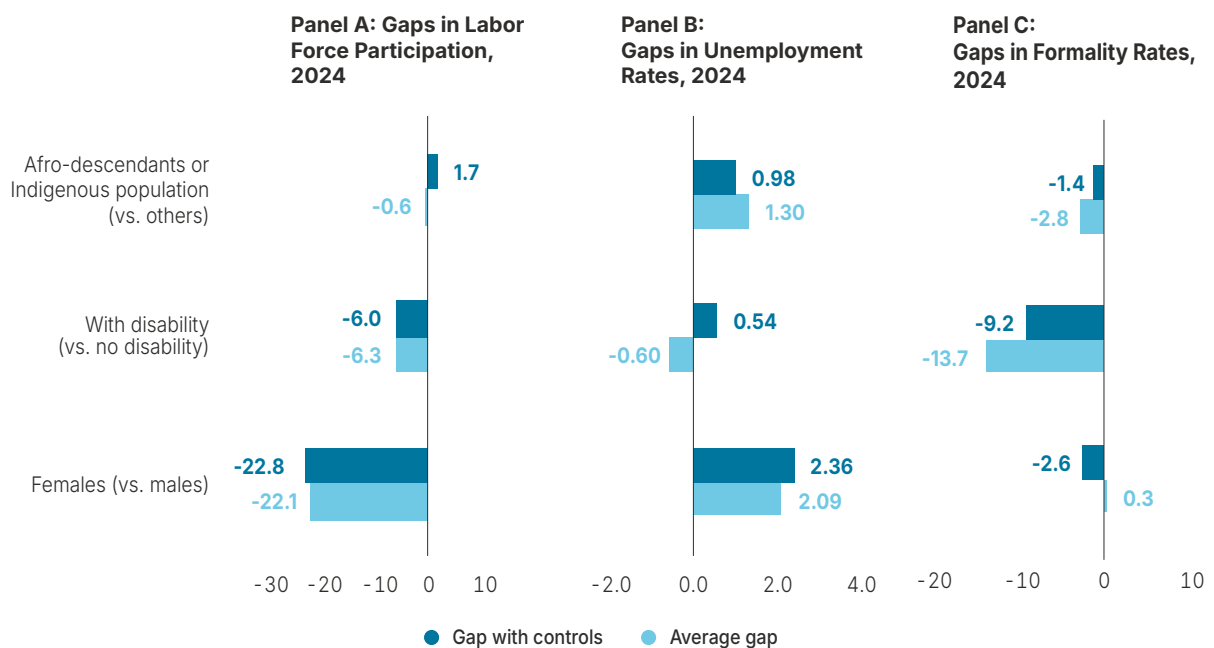
This section examines notable differences in labor market outcomes—such as labor force participation, unemployment, formality, and labor income—across groups defined by immutable personal characteristics, including ethnicity, sex, and disability status. Other important dimensions of heterogeneity, such as language and religion, are not addressed due to limitations in data availability. Migration status is another significant source of disparities.¹⁰ While this section does not provide an exhaustive account of all sources of heterogeneity in labor market outcomes, its purpose is to highlight the equity considerations that should be taken into account when designing labor regulations, which are discussed in Chapters 4 to 6. These disparities show that certain groups of workers encounter greater obstacles to entering the labor market, as well as to obtaining well-paid employment with social security coverage.

¹⁰ In Latin America and the Caribbean, immigrants are more likely than native-born individuals to be employed in most countries, a pattern that contrasts with that observed in nearly all OECD countries. On average, immigrants in the region are also more likely to work in highly skilled occupations. However, they face a higher incidence of informality: 52 percent of foreign-born workers are in informal jobs, compared with 45 percent of native-born workers (IDB, OECD, and UNDP 2023).

Disparities in labor force participation between men and women remain substantial. As discussed earlier in this chapter and shown in Figure 2.3, female labor force participation has increased markedly over the past three decades. Despite this progress, Panel A in Figure 2.31 indicates that the participation gap between men and women remains large, at approximately 22 percentage points, even after controlling for education and years of work experience.

Labor force participation gaps are also observed along other dimensions. Panel A further examines differences by race and ethnicity, and disability status, although data limitations limit a systematic assessment of their evolution over time. Around 2024, the participation gap between people with and without disabilities in Latin America is estimated at about 6 percentage points. For the subset of countries with available data—Colombia, Uruguay, Mexico, Guatemala, Peru, Panama, Ecuador, and Chile—no statistically significant labor force participation differentials by ethnicity are detected.

FIGURE 2.31 LABOR MARKET OUTCOME GAPS



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean for 16 Latin American and Caribbean countries.

Note: Ethnic disparities are based on data from Colombia, Uruguay, Mexico, Guatemala, Peru, Panama, Ecuador, and Chile; disability disparities, on data from Costa Rica, Panama, Colombia, Mexico, Peru, and Chile.

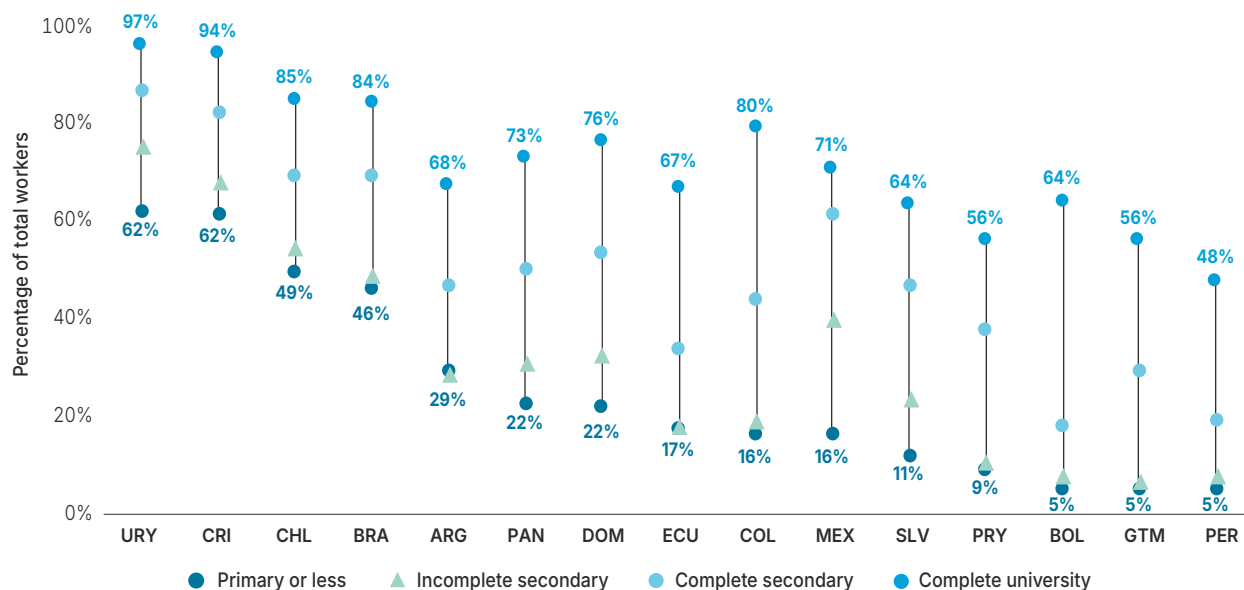
Unemployment gaps are widest among women, followed by Afro-descendant and Indigenous populations. In 2024, Latin American women faced an average unemployment gap of 2.4 percentage points, similar to that of the OECD, at roughly 3 percentage points (OECD 2025). Women face greater difficulties finding jobs, and these barriers increase when considering education and work experience (see Panel B in Figure 2.31). Here again, there are differences across countries. For instance, the Dominican Republic and Guatemala have the highest unemployment gaps between men and women, with women twice as likely to be unemployed as men. On average, Afro-descendant or Indigenous workers have unemployment rates that are about 1 percentage point higher than those of other ethnic groups. These disparities are especially evident among Afro-descendants, who have higher unemployment rates, at 10 percent, compared with workers of other ethnicities, at 7 percent, while Indigenous groups have unemployment rates similar to others. Afro-descendants face higher unemployment rates in 7 out of 8 countries with available data by race, while Indigenous workers face lower unemployment rates in 6 out of 11 surveyed countries.

There are also differences in formality rates across sex, ethnicity, race, and disability status. The largest gap in formality rates is observed between people with and without disabilities, with a gap as large as 13.7 percentage points. Workers who identify as Afro-descendant or Indigenous face, on average, formality rates that are 2.8 percentage points lower than those of workers of other races or ethnicities. In both cases, accounting for differences in education and work experience slightly narrows the formality gaps. By contrast, women face, on average, formalization levels similar to those of men. However, this may hide the fact that women who participate in the labor market tend to be more educated, and more educated workers have higher formality rates, as shown in Figure 2.32. Therefore, when controlling for education and work experience, a formality gap between men and women emerges (see Panel C in Figure 2.31).

Access to a formal job is closely linked to education. Figure 2.32 shows that in every country in the region, highly educated workers are more likely to have formal employment than workers with fewer years of schooling, especially in countries with low formality rates. For instance, in Peru, Guatemala, Bolivia, and Paraguay, countries with overall low levels of formality, around 8 percent of workers who have completed only primary education have a formal job, while around 50 percent of workers with complete university education do.

Workers with disabilities earn 26 percent less than those without—and more than half of that gap cannot be explained by sex, education, or experience.

FIGURE 2.32 FORMALITY RATES BY EDUCATION LEVEL, CIRCA 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, for 2024 or the latest available year.

The age of workers is also a source of differences in access to formal jobs. Young workers have more difficulties finding jobs and have lower formality rates. On average, 33 percent of young workers ages 15–24 have a formal job, compared with 46 percent of workers ages 35–54. Within wage work, the difference is even larger: while 42 percent of young wage workers have access to social security, more than 66 percent of workers ages 35–54 do.

The jobs that women, Indigenous people, Afro-descendants, and people with disabilities access also pay less on average, resulting in wide disparities in labor poverty. Afro-descendant and Indigenous workers face the largest income gaps, earning 41 percent less than workers who identify as neither—a gap that narrows by almost half, to 21 percent, after controlling for education, sex, experience, and other characteristics. Their probability of earning labor income below the poverty line is also disproportionately high: 30 percent among Indigenous workers and 20 percent among Afro-descendants, compared with 14 percent among other workers. Women earn 13 percent less per hour than men on average—23 percent after controls—and labor poverty affects one in five women, compared with 1 in 10 men (see Figures 2.33 and 2.34).¹¹

¹¹ On average, Indigenous workers are twice as likely to earn below the poverty line, a gap particularly striking in Panama, Colombia, and Bolivia, where they are more than three times as likely to do so. Among Afro-descendants, the largest differences were in Colombia and Brazil, where they were at least twice as likely to earn below the poverty line.

2 Three Decades of Modest Progress and Emerging Challenges in Labor Markets

Workers with disabilities earn 23 percent less than those without disabilities, and more than half of this difference is unexplained by sex, education, or experience. They also disproportionately face working poverty compared with workers without disabilities, at 26 percent compared with 17 percent. Given these differences, people with disabilities are at least 60 percent more likely to earn less than the poverty line in all countries with available data, a consistent trend across all countries. Noteworthy cases include Costa Rica, where workers with disabilities are 2.5 times more likely to earn less than the poverty line, and Colombia, where they are twice as likely.

FIGURE 2.33 DISPARITIES IN HOURLY LABOR INCOME, CIRCA 2024

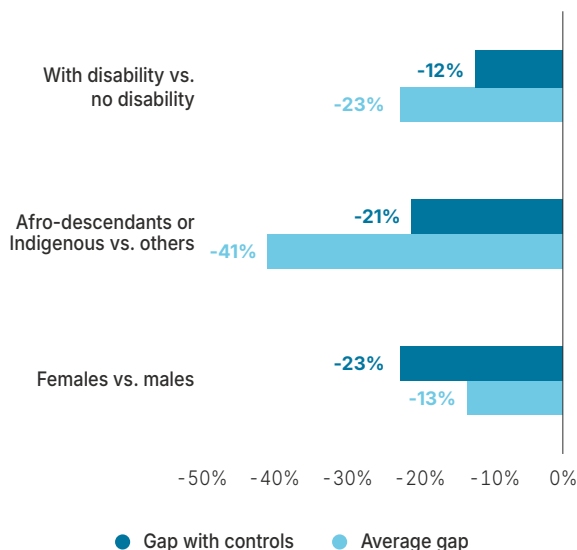
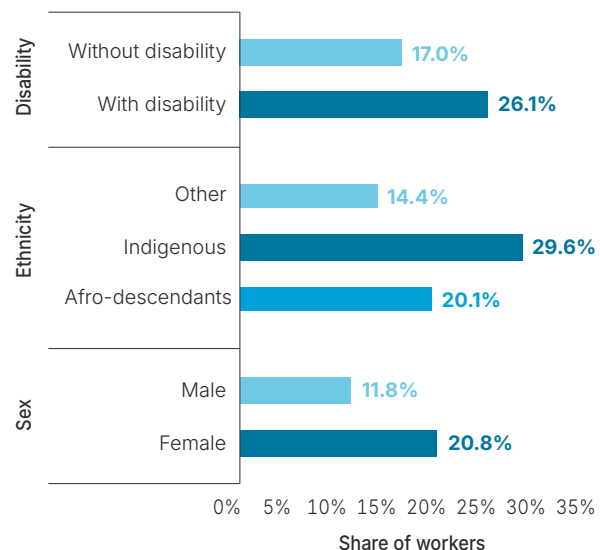


FIGURE 2.34 SHARE OF WORKERS IN WORKING POVERTY (EARNING LESS THAN US\$6.85/DAY, 2017 PPP), CIRCA 2024



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: Controlled estimates for race and disability control for age, years of education, sex, and country fixed effects. Hourly wages are winsorized by trimming the top and bottom 1 percent of the distribution. Sex disparities are based on data from 17 Latin American and Caribbean countries; ethnic disparities, on data from Colombia, Uruguay, Mexico, Guatemala, Peru, Ecuador, and Chile for self-reported ethnic backgrounds accounting for more than 1 percent of total workers; disability disparities, on data from Costa Rica, Panama, Colombia, Mexico, Peru, and Chile.

The key takeaway is that significant disparities persist across groups in access to the labor market, as well as to formal and well-paid jobs. In general, these gaps narrow when controlling for education, indicating that much of the exclusion originates before entry into the labor market. However, even after accounting for education and work experience, substantial

gaps remain, highlighting additional barriers that policymakers need to address. These barriers may include limited access to care services, cultural norms, stereotypes, discrimination, and physical or informational accessibility. The persistence of these gaps underscores the importance of targeted active labor market policies, which will be discussed in Chapter 6 and have been shown to be cost-effective in improving outcomes for these groups.

2.4 Rising Labor Market Pressures from Technology and Demographics

Technological change and demographic transitions are intensifying existing labor market challenges and creating new pressures on employment, skills, and social protection systems in the region. As the region continues to face long-standing labor market challenges such as high informality, low productivity, and persistent inequality, new trends are adding layers of complexity. Technological change and demographic transition are emerging as central forces shaping labor supply, labor demand, and the nature of work in the region, with important implications for employment, job quality, and long-term income growth.

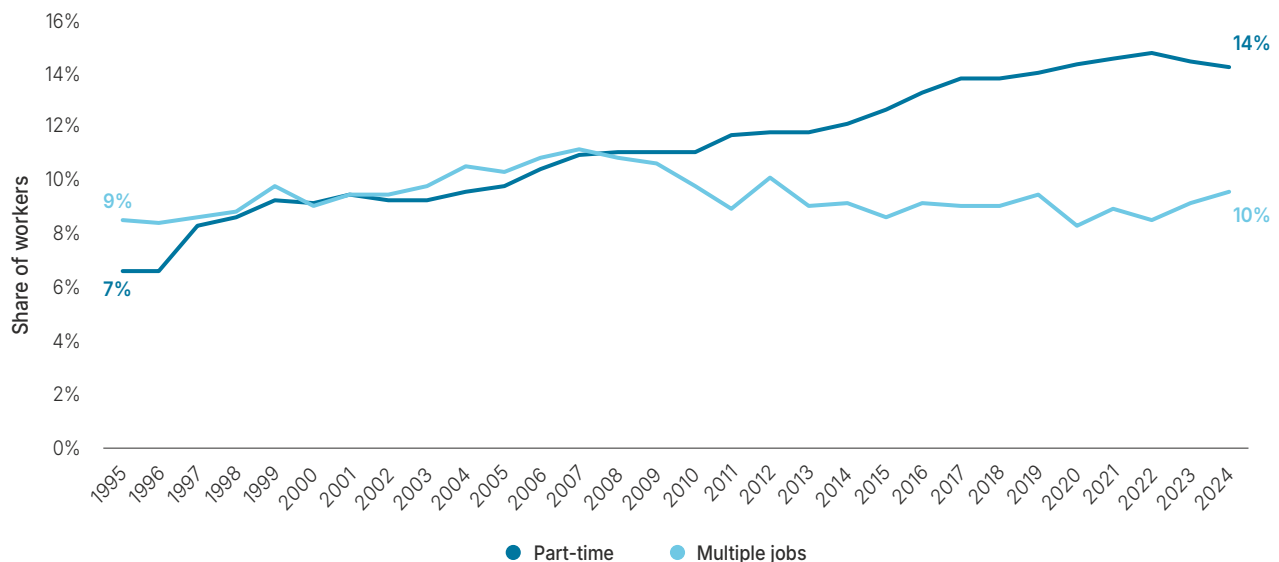
2.4.1 Technology Is Enabling New Forms of Work, but Adoption Is Slow in the Region

Part-time work has increased markedly in the region, while multiple job-holding has remained largely unchanged. Part-time employment—defined as working fewer than 30 hours per week in the main job and distinct from underemployment, as part-time workers do not necessarily wish to work additional hours—has risen steadily over the past two decades. Figure 2.35 shows that the share of part-time jobs doubled from 7 percent of total employment in 1995 to 14 percent in 2024 across the region. Countries that have experienced particularly consistent increases in part-time work over this period include Panama, Bolivia, Peru, and Ecuador. By contrast, the proportion of workers holding multiple jobs has remained stable at around 9 percent to 10 percent. This stability is consistent with the interpretation that the rise in part-time work largely reflects voluntary choices rather than insufficient labor demand, as many part-time workers do not appear to seek additional hours through secondary employment.

Part-time work is particularly prevalent among women and young workers. Across all Latin American and Caribbean countries, the share of women working part time is consistently higher than that of men. Reflecting persistent social norms and biases, women devote more

time to unpaid work and domestic responsibilities and are therefore more likely to opt for part-time employment (Araujo et al. 2024). On average, 22 percent of women work part time—more than twice the proportion observed among men, at 10 percent. A cohort analysis further shows that part-time work has increased markedly among younger workers in the region. As Figure 2.36 shows, the propensity to work part time by choice follows a U-shaped pattern over the life cycle, with higher incidence among both younger and older workers. However, there is a clear upward shift among younger cohorts: Millennials, born between 1981 and 1996, and Generation Z, born between 1997 and 2012, exhibit a higher likelihood of working part time at ages 20–24 than Generation X, born between 1965 and 1980. Although multiple hypotheses may explain this trend, the fact that part-time work appears to be rising makes it imperative to regulate part-time work efficiently, which will be addressed in Chapter 8.

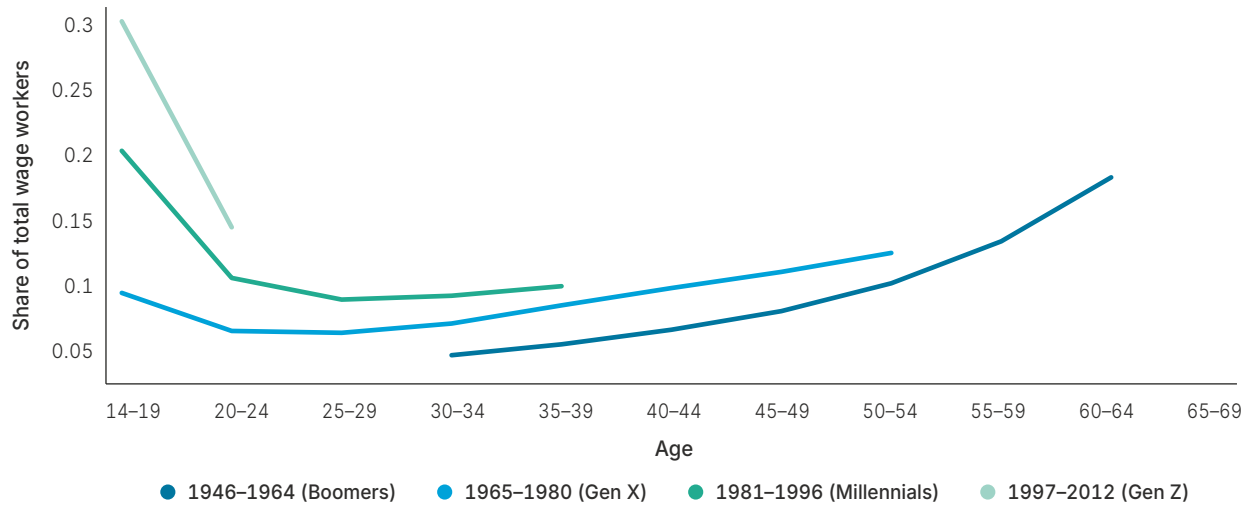
FIGURE 2.35 PART-TIME JOBS AND MULTIPLE JOB-HOLDING (LAC-12)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

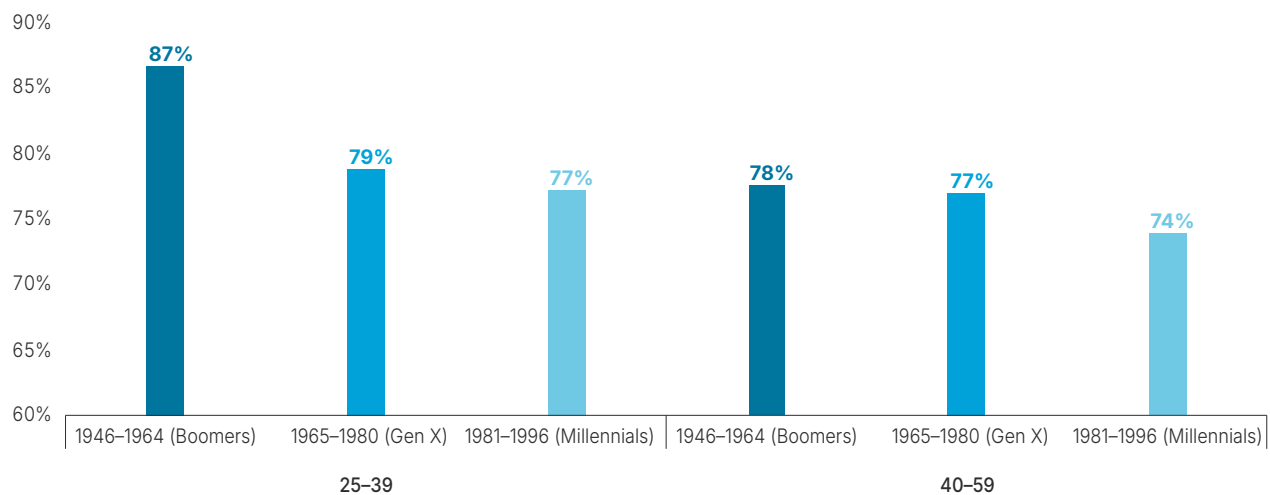
Note: Part-time jobs are defined as jobs held by workers who work fewer than 30 hours per week and do not want additional hours.

FIGURE 2.36 SHARE OF WORKERS EMPLOYED PART TIME (LAC-12)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 12 Latin American and Caribbean countries.

FIGURE 2.37 PART-TIME WORKERS WITHOUT SOCIAL SECURITY, BY COHORT AND AGE GROUP (SHARE OF TOTAL PART-TIME WORKERS, LAC-12)



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean; unweighted average of 12 Latin American and Caribbean countries.

Note: A worker holds an informal job when they lack access to social security.

Younger generations are slightly less likely to hold informal part-time jobs than older generations at the same age, mirroring broader trends toward greater formality over time. For example, Figure 2.37 shows that 87 percent of part-time baby boomers did not have social security coverage when they were between 25 and 39 years old, compared with 77 percent of part-time Millennials at the same ages. Despite this generational improvement, most part-time workers remain informal. As discussed in greater detail in Chapters 4 and 5, this pattern may reflect the design of labor regulations, which often impose disproportionately high nonwage costs on part-time employment, discouraging formalization. As part-time work continues to expand, adapting labor regulations to facilitate compliance with social security contributions will be essential, a theme explored further in Chapter 5.

Telework Is Expanding but Remains Constrained

The onset of the pandemic accelerated the adoption of telework, whether fully remote or hybrid, in Latin America and the Caribbean, as well as the adoption of new regulatory frameworks, as will be shown in Chapters 4 and 8. However, vacancy data still show a low incidence of telework. Job vacancy statistics from the IDB's Labor Market Observatory for 15 Latin American and Caribbean countries¹² reveal that the adoption of telework varies by country and over time. Although telework existed before the pandemic, its adoption was not widespread. In 2019, the percentage of job listings mentioning remote work was very low, at 1 percent or less of new monthly vacancies.¹³ With the arrival of the pandemic in 2020, this percentage increased quickly and significantly in all countries with available data. From the second half of 2021, a declining trend in telework adoption was observed in most countries, coinciding with a general recovery in employment to pre-pandemic levels. Current vacancy data suggest that these economies may have reached a natural telework rate of 1 to 7 percent, with a regional average of 4 percent in 2025 (Figure 2.38).

Telework remains limited in practice across Latin America, despite data suggesting a higher potential for remote work. While vacancy data are very useful for analyzing labor demand and identifying trends in telework, they have limitations in terms of representativeness. Household surveys in Brazil, Chile, the Dominican Republic, Guatemala, Panama, and Uruguay confirm that between 1 and 7 percent of workers teleworked in 2024, with a regional average of 4 percent, aligning with recent vacancy data. These figures are well below estimates for the United States, where 19.5 percent of employed individuals reported teleworking or working from home for pay (Bureau of Labor Statistics 2023). Current levels are also below the

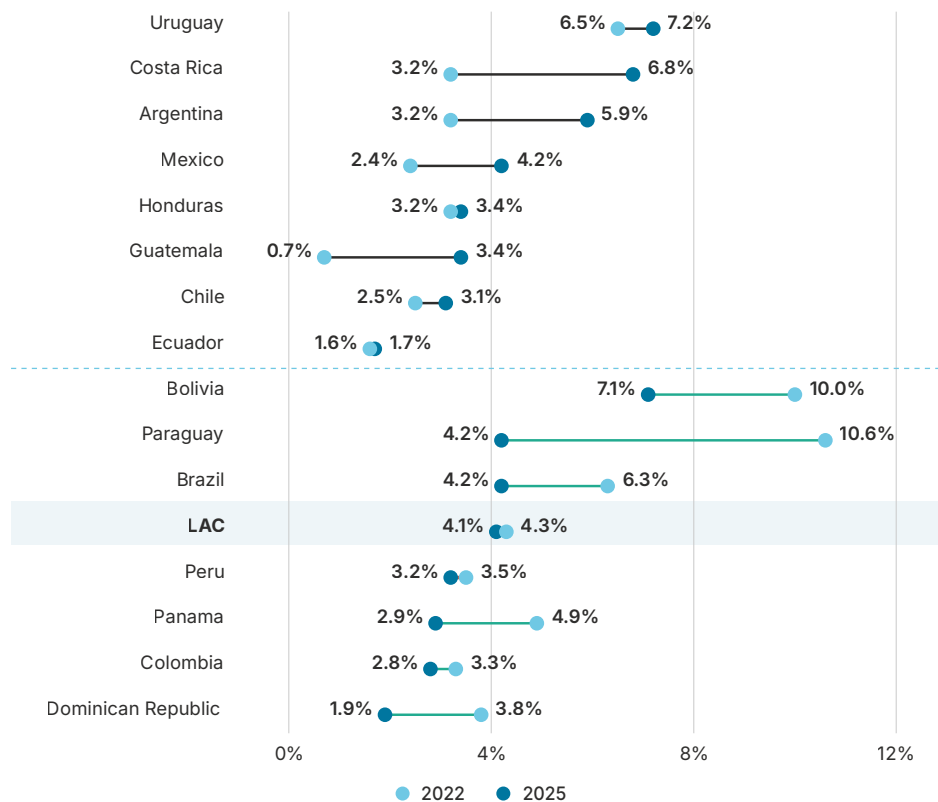
¹². Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru, and Uruguay.

¹³. Based on Granada, Altamirano, and Saraceno (2022), using data from Computrabajo.

lower bound of theoretical estimates of telework reported in Delaporte and Peña (2020). For example, although an estimated 7 percent of workers in Guatemala could potentially telework, in practice only 4 percent do so. Similarly, in Panama, up to 14 percent of workers could work remotely, yet survey data indicate that only about 5 percent actually teleworked in 2024.

This shows that, beyond the characteristics of the labor force, tasks, and the structure of the economy, there are other constraints to the adoption of telework. Alaimo et al. (2022) point out that, in addition to incompatibility with production, employers report that the main constraints to the adoption of telework are labor regulation, at 15.4 percent; the fact that it creates inequalities, at 12.8 percent; problems with internet connectivity, at 10.3 percent; and difficulty supervising workers, at 7.7 percent. The policy implications of these reasons are quite different. If telework is truly incompatible with a firm's production process, it should not be adopted. On the other hand, if labor regulations prevent workers and firms from making mutually beneficial telework agreements, policymakers should improve the regulation.

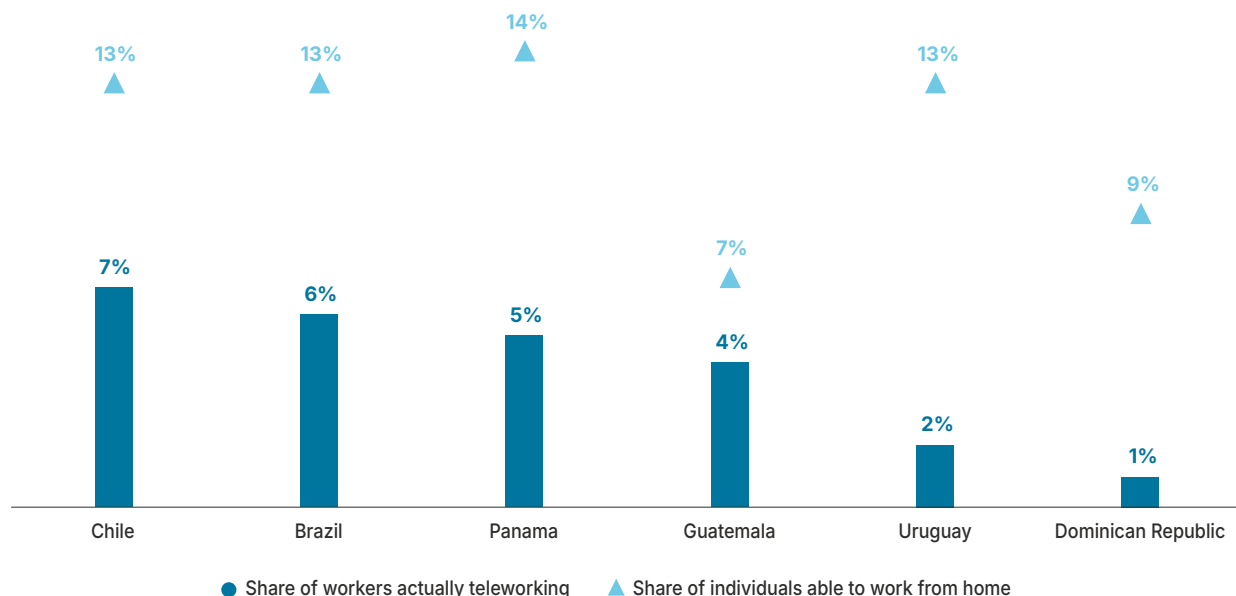
FIGURE 2.38 VACANCIES ASSOCIATED WITH TELEWORKING (% OF TOTAL JOB LISTINGS)



Source: Authors' calculations, based on vacancy data for Latin American and Caribbean countries from the IDB's Labor Market Observatory.

Note: In green, countries where the telework share fell between 2022 and 2025.

FIGURE 2.39 SHARE OF WORKERS WHO CAN TELEWORK VS. THOSE WHO ACTUALLY DO



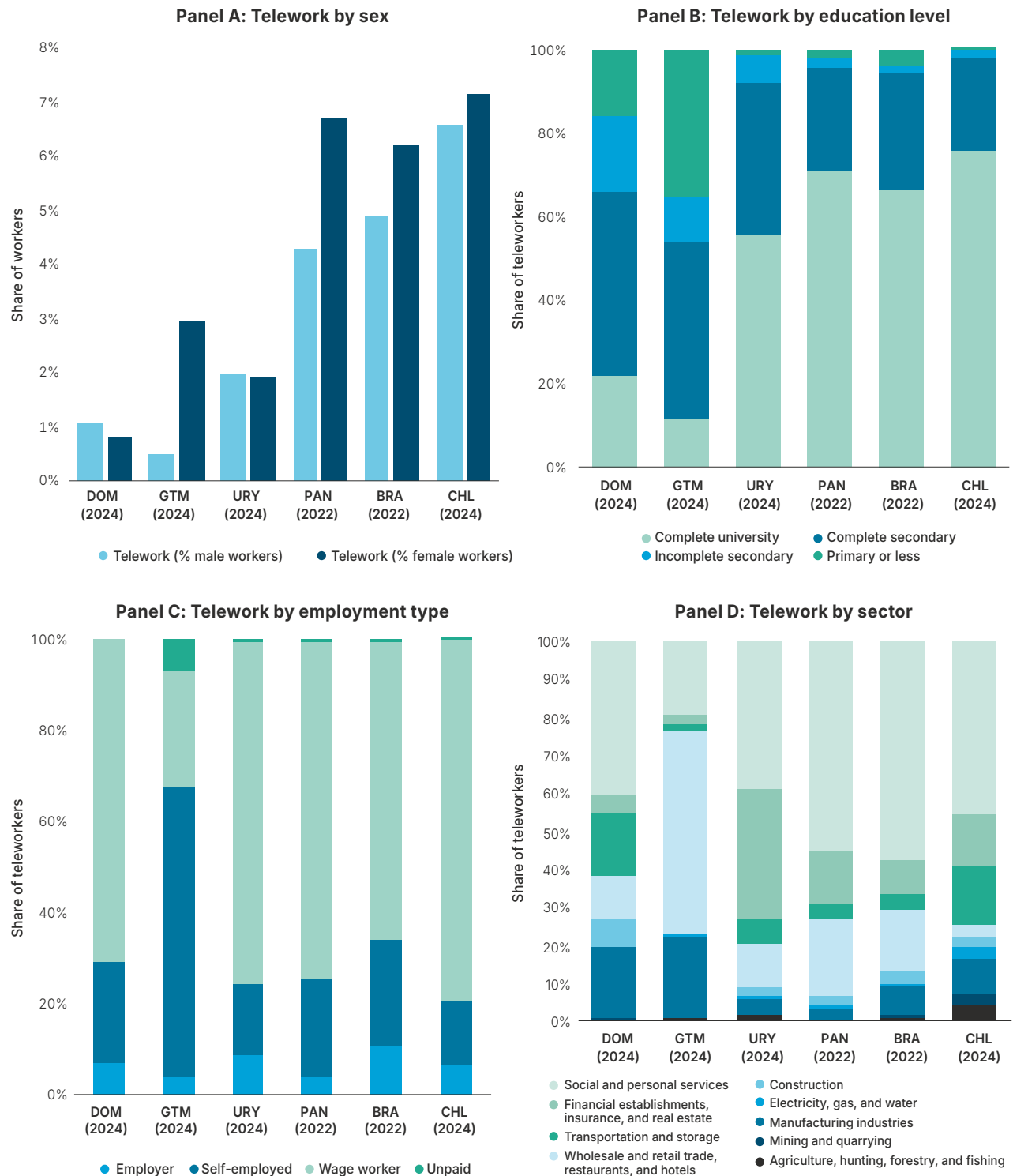
Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean for 2022 and 2023, and on Delaporte and Peña (2020) feasibility estimates.

A key characteristic of telework is that it is largely accessible to workers who already hold advantages in the labor market and have access to internet connectivity, such as highly educated professionals. Telework is strongly associated with skill intensity and occupational sophistication, raising concerns that it may widen existing inequalities. Figure 2.40 shows that in countries with a higher proportion of telework, around 70 percent of teleworkers have some university education, even though workers with complete university studies account for only 17.6 percent of total employment in the region. Most teleworkers are wage employees, and between 40 and 60 percent work in social, personal, and financial services, except in Guatemala. By contrast, telework remains rare in lower-skilled occupations: while more than half of managers and professional workers telework, only about 10 percent of workers in agriculture, manual trades, industry, transport, and elementary occupations do so (Alaimo et al. 2022). Overall, telework in the region remains concentrated among a relatively narrow group of professionals, suggesting that flexible work arrangements may increase labor market inequalities.

Although more employed women than men telework, as shown in Figure 2.40, there is no clear evidence that telework helps reduce pay gaps between men and women. Prevailing social expectations and managerial culture influence women's preferences for telework as

a way to achieve work-life balance (Touzet 2023). In Mexico, women with higher education are more likely to jointly generate household production—that is, care for dependents—and work production when working from home, providing an incentive to remain in the labor force (Inchauste and Siravegna 2024). But telework is not a substitute for good care services (Inchauste and Siravegna 2024) and can reinforce social norms that household work is a female responsibility (Alaimo et al. 2022). While the availability of telework might facilitate participation among women with small children (Busso and Fonseca 2015; Inchauste and Siravegna 2024), recent evidence for Latin America suggests that it might widen pay gaps between men and women. A study in Colombia, Peru, Mexico, Chile, and Argentina shows that, on average, women were willing to give up 10 percent of their salary for a fully remote job, whereas men were not (Diaz et al. 2024).

FIGURE 2.40 TELEWORKERS' CHARACTERISTICS, BASED ON HOUSEHOLD SURVEY DATA



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Platform Work: A Significant Share of Workers

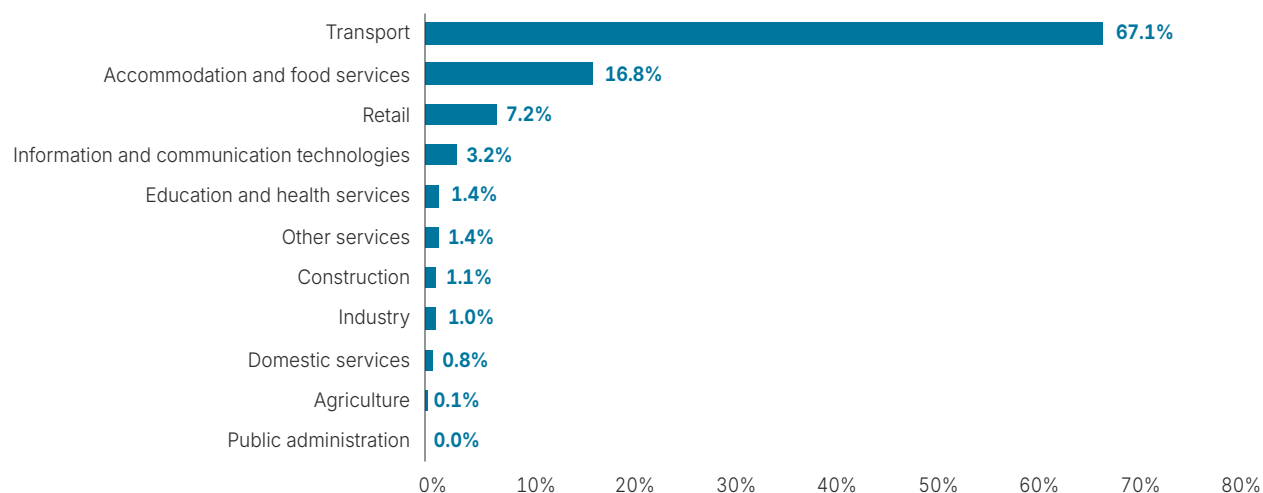
Due to technological advancements, new forms of work have emerged in the region, broadening opportunities for workers to access employment and income-generating activities. These technological advancements have enabled the emergence of digital platforms, which can be grouped into two types of platform work. The first type is online, web-based platforms where tasks are performed remotely, for example, freelance platforms that connect workers with clients for services such as graphic design. These platforms offer significant opportunities for workers to provide services in international markets. Large platforms often host workers from around the world, allowing businesses to complete tasks more quickly and at lower costs. Often, this facilitates outsourcing from developed countries to developing nations where wages are lower. The second type is location-based platforms, where work is performed at a specific physical location, such as transportation or delivery services or domestic work provided in private homes. These platforms, particularly in transportation and delivery, have disrupted traditional business models (ILO 2021a).

Platform work emerged less than 30 years ago, but it has grown rapidly worldwide and in Latin America and the Caribbean. In 2008, there were fewer than 100 such platforms; by 2020, there were more than 800. Between 2016 and 2023, global demand for gig work, including platform work, increased by 41 percent, according to the Online Labour Index (Datta et al. 2023). Estimating the amount of work generated through these platforms is difficult because platforms rarely disclose figures, and statistical surveys face challenges in collecting accurate data. For instance, labor force surveys often lack relevant questions or suffer from low sample sizes and definitional issues. A recent World Bank study, combining data science methods, web traffic analysis, and survey data, estimates that 47 million individuals in Latin America and the Caribbean offer services via digital platforms, representing about 19 percent of the total workforce in the region (ILO 2021a; OECD, ILO, and European Union 2023; Datta et al. 2023). The share of platform workers in the global labor force ranges from 4.4 to 12.5 percent, but for many of them, platform work is a secondary occupation (Datta et al. 2023). Only approximately 25 percent of these workers perform platform work as their main occupation; for the rest, it is a secondary or marginal occupation. This means that workers who perform platform work as their main job represent around 4.7 percent of total workers in the region. However, Datta et al. (2023) point out that these estimates are more than four times higher than those suggested by labor force surveys.

Although the share of platform workers is significant in Latin America and the Caribbean, it still represents a small share of work. In Brazil, 1.46 million workers performed platform work as their main employment, representing 1.5 percent of all workers in 2022 (Figure 2.41). Brazil's

2022 household survey,¹⁴ which included a module to analyze platform workers, defines them as individuals who provide services through various digital applications.¹⁵ There are important differences across sectors: platform workers represent 19 percent of all transport workers and 5 percent of workers in accommodation and food services.

FIGURE 2.41 DISTRIBUTION OF PLATFORM WORKERS BY SECTOR, BRAZIL



Source: Authors' calculations, based on Brazil's 2022 household survey (PNADC).

The emergence of new forms of work arrangements is a fact, and there are good and bad reasons why people may choose them. If individuals choose these work arrangements because they represent the most productive options or are most closely aligned with their preferences, and if they are protected against the risks of participating in work, their introduction would represent a productivity-enhancing change that promises to improve labor outcomes. On the other hand, if people choose these forms of work because poorly designed regulations drive them away from more traditional forms of work, or because people in new forms of work are exempted, in law or in practice, from tax and social security obligations, we are facing a policy-induced problem that demands policy reform as a solution.

14. Pesquisa Nacional por Amostra de Domicílios Contínua (PNADC).

15. These include taxi apps such as 99taxi, cooperative apps, or city hall apps; private passenger transport apps like Uber, 99, or other regional or local applications; food and product delivery apps such as iFood, Rappi, Loggi, or other regional or local applications; and general or professional service provision apps such as GetNinjas, Parafuzo, Freelancer, Workana, and 99freela.

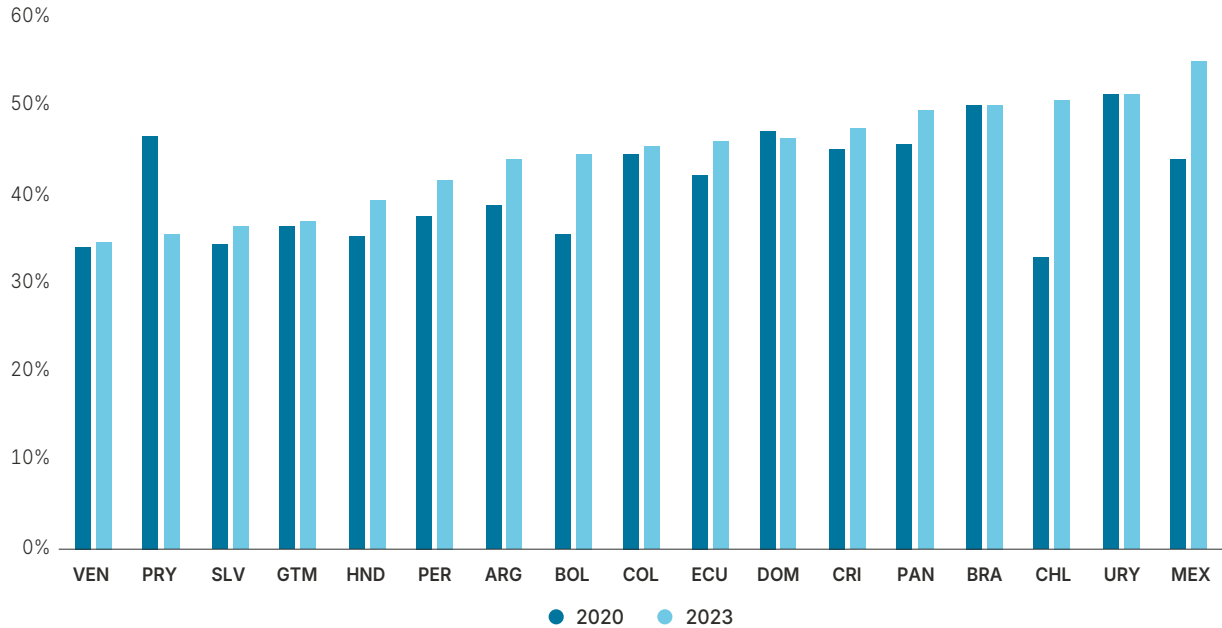
Automation: Modest Impact So Far, Uncertain Future

Technological change today raises concerns among workers in Latin America and the Caribbean. Technological change has always existed, and fear of losing jobs to machines goes back more than one hundred years, from horseless carriages to automatic elevators to ATMs (Anslow 2023). Later innovations, such as the computer age, robotics, and, more recently, generative artificial intelligence (AI), have sustained the fear that machines are coming for our jobs. Deming, Ong, and Summers (2025) study past episodes of technological disruption in the US labor market and find that the pace of change has slowed over time. The years from 1990 to 2017 were less disruptive than any prior period they measure, going back to 1880. This comparative decline is not because the job market is stable today, but rather because past changes were so profound. In other words, technology is changing the labor market, but it is not clear that it is doing so more rapidly than in the past.

The fact that technology has always changed the labor market does not change the fact that people are worried about the impact of new technologies on their jobs. In 2023, around 45 percent of Latin Americans said that robots would take away their jobs in the next 10 years or more, a concern that is increasing in most countries. This concern is greater in higher-income countries and countries with large manufacturing sectors, such as Mexico (55 percent), Uruguay (51 percent), Chile (51 percent), Brazil (50 percent), and Panama (50 percent).

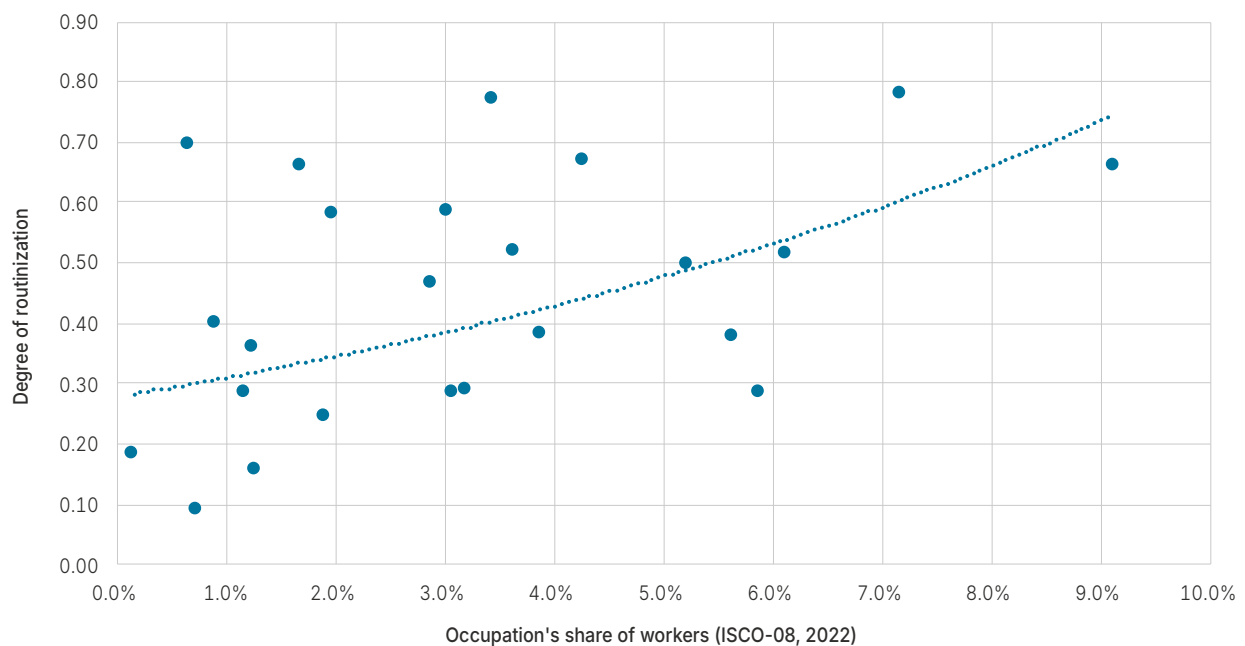
The fear that machines are coming for our jobs goes back more than a century — from horseless carriages to automatic elevators to ATMs.

FIGURE 2.42 PERCEIVED AUTOMATION RISK: "ROBOTS WILL TAKE MY JOB IN 10 YEARS OR MORE" (% OF RESPONDENTS WHO AGREE OR STRONGLY AGREE)



Source: Authors' calculations, based on Latinobarómetro data.

FIGURE 2.43 SHARE OF WORKERS BY OCCUPATION AND DEGREE OF TASK ROUTINIZATION, 2022



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, and Ciaschi, Galeano, and Gasparini (2021) routinization estimates.

These concerns are supported by evidence. A large share of jobs in the region has significant routine task content and is therefore highly automatable. There is also evidence that employment in occupations with high routine content has decreased slightly. Using household surveys, we apply the routine task estimate calculated by Ciaschi, Galeano, and Gasparini (2021) to assess the routine task content of workers' actual jobs in 22 Latin American and Caribbean countries. This index is constructed from information on actual tasks performed by Latin American workers using data from four Latin American and Caribbean countries in the Programme for the International Assessment of Adult Competencies survey, and it captures the percentage of individuals within an occupation who mostly perform routine tasks. We observe that the occupations that employ more workers in the region also have a higher degree of routine tasks, as shown by the positive correlation in Figure 2.43.

Second, data from job postings in the region show that there is high demand for low-skilled jobs with a high risk of automation. Table 2.2 summarizes vacancies from online job boards in Argentina, Brazil, Chile, Colombia, Guatemala, Mexico, Uruguay, and Venezuela between 2020 and 2022. It categorizes vacancies using the Autor and Dorn (2013) methodology, which assesses the risk of automation by identifying occupations with a high intensity of routine tasks, as these are more likely to be replaced by computers, software, or machines as technology advances. Job postings in Latin America and the Caribbean are biased toward routine cognitive tasks, which have a high risk of automation. In Argentina, Chile, Colombia, Guatemala, Uruguay, and Venezuela, between 26 and 30 percent of routine cognitive vacancies advertised on job boards require skills with a high risk of automation. Similar findings are obtained by González-Velosa and Peña Tenjo (2019) and Di Capua, Queijo, and Rucci (2020). A significant share of job postings in these countries specifies a minimum education requirement, and around 50 percent require only a high school diploma. In Colombia and Mexico, around 40 and 30 percent of vacancies, respectively, also require a college degree. This is aligned with the findings of Ciaschi, Galeano, and Gasparini (2021), which indicate that the degree of task routinization is higher among low-skilled occupations and occupations with low relative wages. Although these boards are not representative of the whole economy, they provide a detailed view of a very important segment of the labor market: low-skilled jobs in the service and commerce sectors with high turnover.

TABLE 2.2 VACANCIES AT HIGH RISK OF AUTOMATION, 2022

COUNTRY	ROUTINE MANUAL	NONROUTINE PHYSICAL MANUAL	ROUTINE COGNITIVE
Argentina	7%	9%	27%
Brazil	1%	2%	14%
Chile	9%	6%	27%
Colombia	5%	5%	30%
Guatemala	2%	4%	27%
Mexico	3%	6%	21%
Uruguay	4%	8%	30%
Venezuela	3%	4%	26%

Source: Authors' calculations, based on the IDB vacancies database and the Autor and Dorn (2013) methodology.

Third, there is evidence that employment in occupations with high routine content has decreased slightly. Using data for Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, and Peru between 1992 and 2015, Brambilla et al. (2023) find that the acceleration of technology adoption, measured by the purchase of industrial robots, reduces employment more rapidly in industries with a high concentration of routine tasks. However, the labor share remains unchanged on average, as the wages of workers who remain employed rise weakly. Ciaschi, Galeano, and Gasparini (2021) find that, in the first two decades of the twenty-first century, the overall content of routine tasks in occupations decreased, as occupations with higher degrees of routinization reduced their employment share. They also find that high-routine occupations experienced reductions in employment share but not in real or relative wages. Our estimates for 22 Latin American and Caribbean countries also indicate that employment in high-routine occupations decreased between 2000 and 2022; however, this decline was driven mainly by reductions in two occupations: agricultural workers and cleaners and helpers.

Artificial Intelligence: Low Adoption, Rising Exposure

Unlike other automation technologies, artificial intelligence (AI) can substitute for both routine and some nonroutine tasks. Despite growing efforts to understand the impact of AI, both the magnitude and nature of its effects remain highly uncertain as of early 2026. On one hand, multiple studies in advanced economies estimate productivity gains from AI, especially in occupations with automatable tasks (Noy and Zhang 2023; Peng et al. 2023; Acemoglu 2024; Brynjolfsson, Li, and Raymond 2025). However, Hampole et al. (2025) find that when AI can perform most tasks in a role, employment in that role within a firm falls by about 14 percent.

But when AI affects only a few tasks, employment can grow. AI's impact on the labor market in Latin America and the Caribbean will critically depend on the degree of exposure and adoption.

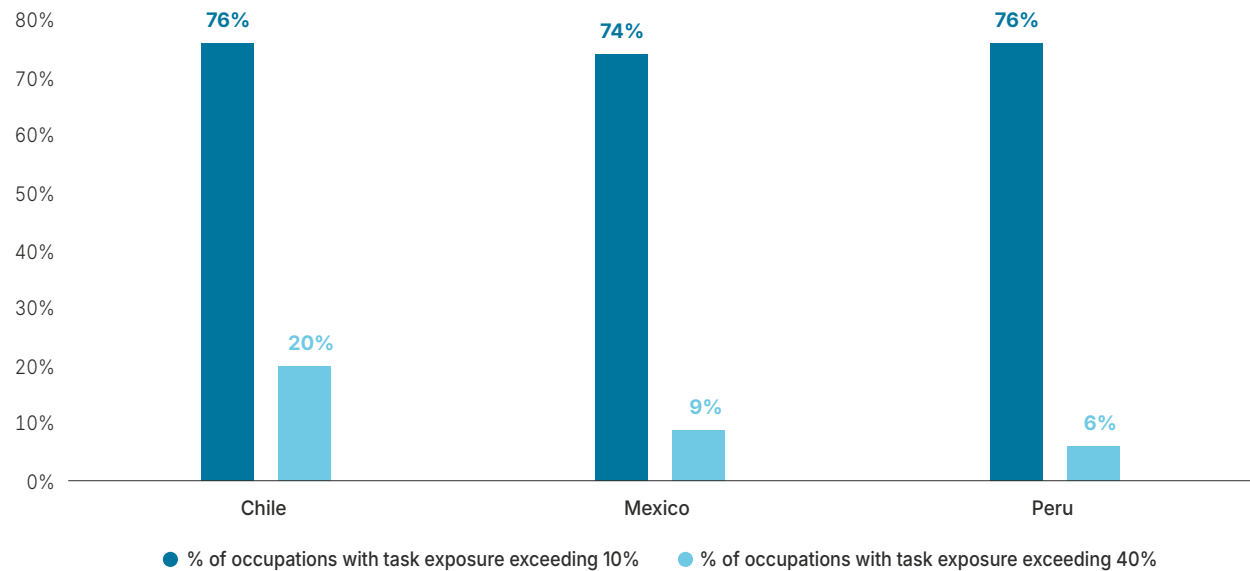
Exposure of jobs to generative artificial intelligence remains low but is expected to increase in the coming years. Benítez and Parrado (2024) define exposure as the likelihood that a given job will be displaced by AI technologies. They estimate that, over a one-year horizon, 83 percent of jobs in Mexico have low exposure to AI and only 5 percent have high exposure. Over a ten-year horizon, exposure rises, and about 30 percent of jobs become highly exposed—similar to the share in the United States.

Azuara, Ripani, and Torres (2024) estimate similar results for Mexico, Peru, and Chile using a task-based framework. The share of jobs with more than 10 percent of tasks exposed to large language models (LLMs) is 76 percent in Chile and Peru and 74 percent in Mexico. Raising the exposure threshold to 40 percent of tasks reduces the share of affected jobs to 20 percent in Chile, 9 percent in Mexico, and 6 percent in Peru. Azuara, Ripani, and Torres (2024) also note that formal, highly educated, and highly paid workers are more likely to work in firms with better access to technology, infrastructure, and organizational support for technology adoption, and in roles that benefit from automation and AI assistance. The structure and organization of formal jobs make integrating LLMs easier than in informal jobs.

More recently, Douenne et al. (2026) estimate the share of tasks within each occupation that AI technologies could perform or substantially accelerate across 17 countries in Latin America and the Caribbean. They find that administrative and middle-management staff display by far the highest exposure, at 47.5 percent, reflecting the large share of tasks involving documentation, information processing, scheduling, and communication. Professionals and technicians follow at 19.0 percent, while agricultural workers (6.3 percent) and nonagricultural operators (6.9 percent) show the lowest exposure. They also confirm the earlier findings of Azuara, Ripani, and Torres (2024) that formal jobs are more exposed than informal ones to AI performing or accelerating their tasks.

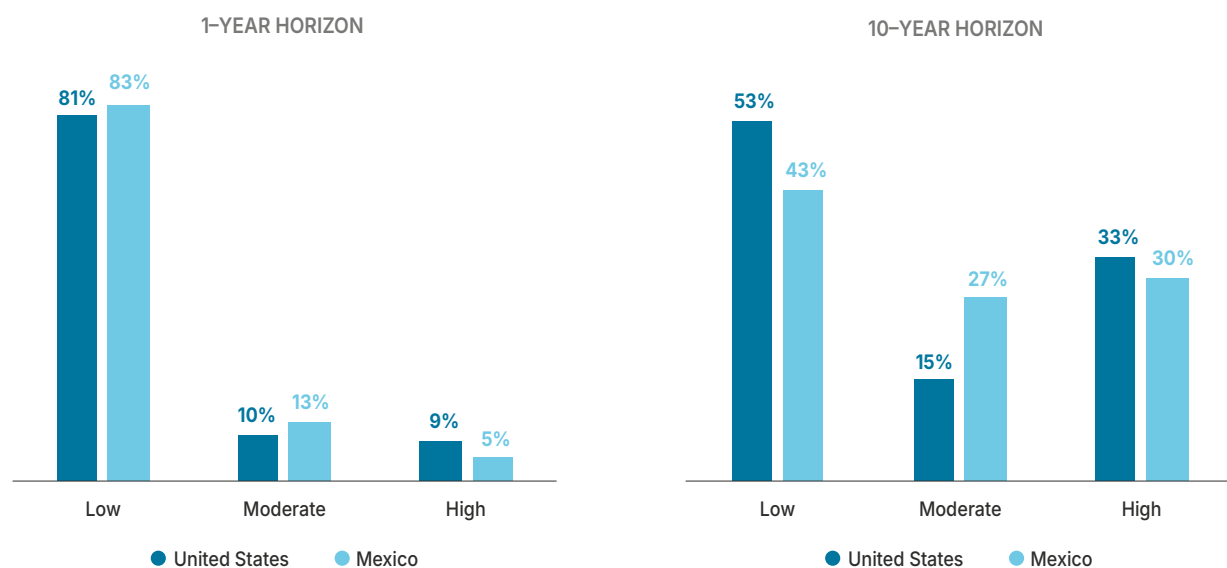
2 Three Decades of Modest Progress and Emerging Challenges in Labor Markets

FIGURE 2.44 OCCUPATIONAL TASK EXPOSURE TO LLMS IN LATIN AMERICA AND THE CARIBBEAN (SHARE OF TOTAL OCCUPATIONS)



Source: Azuara, Ripani, and Torres (2024).

FIGURE 2.45 JOB EXPOSURE TO AI (SHARE OF TOTAL JOBS)



Source: Authors' calculations, based on Benítez and Parrado (2024).

As of 2026, the pace of adoption is still relatively modest. Consumer use of AI in Latin America is growing (ECLAC and CENIA 2025), but task-level evidence suggests that productive adoption is low. As of 2026, the top 20 countries accounted for 48 percent of all per capita usage of AI products (Massenkoff, Lyubich, and McCrory 2026), and low-adoption countries fell slightly further behind rather than converging. AI's impact on the labor market depends on whether it primarily raises productivity or substitutes for labor, capital, or both, and how these effects vary across occupations and types of technology; for example, machine-learning-based predictive models differ markedly from natural language processing applications. Broader considerations—such as whether AI augments upstream or downstream tasks, alters quality-to-price ratios, or expands overall market demand—will further shape its impact (Agrawal, Gans, and Goldfarb 2019; Acemoglu 2024; Autor 2024).

A key question is whether all these technological advances—robots, AI, new forms of work, and labor-replacing technologies in general—are truly productivity-enhancing. If they are, our productivity focus will lead us to welcome their adoption. We will recommend strengthened social protection and active labor market policies to mitigate negative impacts on workers, but we certainly would not want to prevent progress. Our concern, however, is that the main motivation for adopting a labor-replacing technology may be to avoid poor labor regulations or high labor and social security taxes, rather than to improve productivity. Chapters 4–6 will address this potentially important policy issue.

Regardless of these uncertainties, investment in skills development will help build a workforce better prepared to adapt to technological change, while strong social protection systems can cushion workers against shocks and facilitate job transitions. These issues are discussed in Chapters 5, 6, and 8.

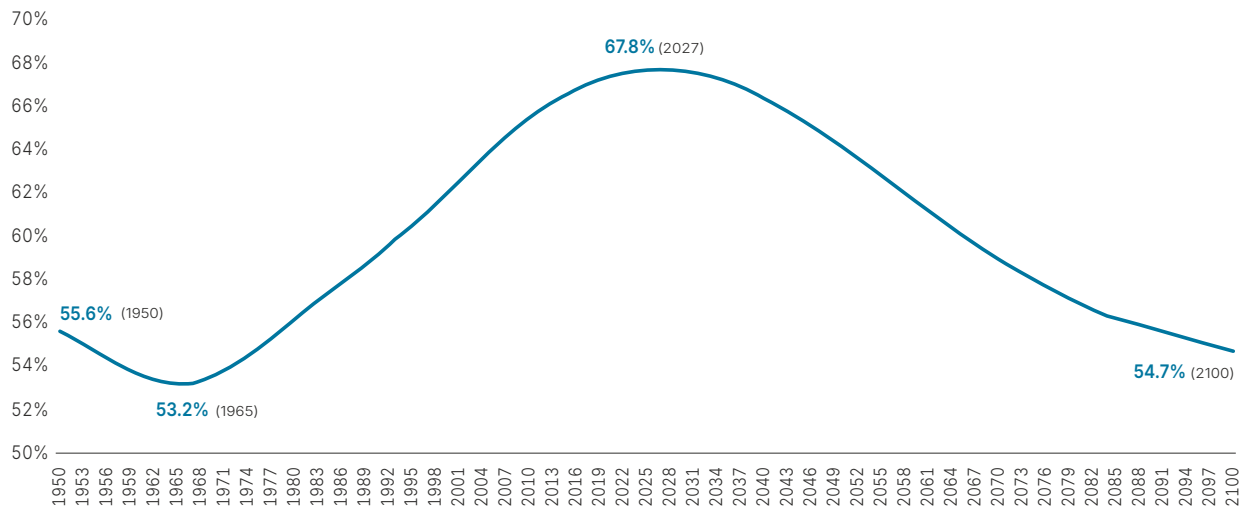
2.4.2 From Demographic Tailwinds to Headwinds

As discussed in the first section of this chapter, over the past several decades Latin America and the Caribbean has benefited from favorable demographic trends that expanded the labor force, making labor accumulation one of the main drivers of GDP per capita growth in the region. Between 1960 and 2019, GDP per capita grew at an average annual rate of 1.77 percent. Labor accumulation accounted for 34 percent of this growth, while other accumulation factors—capital deepening and increased schooling—contributed 6 and 56 percent, respectively. However, the region is undergoing a demographic transition,¹⁶ as fertility rates are declining and life expectancy is increasing, which is reshaping prospects for economic growth and placing new pressures on labor markets and social security systems. This section briefly outlines the key features of this transition and its emerging challenges.

First, as fertility rates decline and populations age, the region's demographic dividend is gradually fading, removing one of the key engines of growth. Favorable demographic conditions are expected to persist for only a few more years. Figure 2.46 shows the working-age population, ages 15–64, as a share of the total population in the region. In 1965, this share stood at 53.2 percent. From the mid-1960s onward, the working-age share increased steadily, generating a demographic dividend that expanded labor supply and supported economic growth. The working-age population share is projected to peak in 2027, after which it will begin a sustained decline across the region. As this dividend ends, the contribution of labor accumulation to per capita GDP growth will diminish, highlighting the urgent need for productivity gains and more efficient use of labor to sustain growth. This represents a major challenge, as total factor productivity (TFP) has historically contributed very little to regional GDP growth. Between 1960 and 2019, productivity added only 0.06 percentage points per year to per capita GDP growth, with negative growth observed in many countries. Without substantial improvements in productivity, maintaining the growth rates achieved over the past six decades will be nearly impossible.

16. Total fertility fell from one of the highest rates globally in 1950 (5.8 births per woman) to one of the lowest in 2022 (1.8), while life expectancy increased markedly from 48.6 to 73.8 years (ECLAC 2024b).

FIGURE 2.46 WORKING-AGE POPULATION AS A SHARE OF TOTAL POPULATION, LATIN AMERICA AND THE CARIBBEAN, 1950–2100

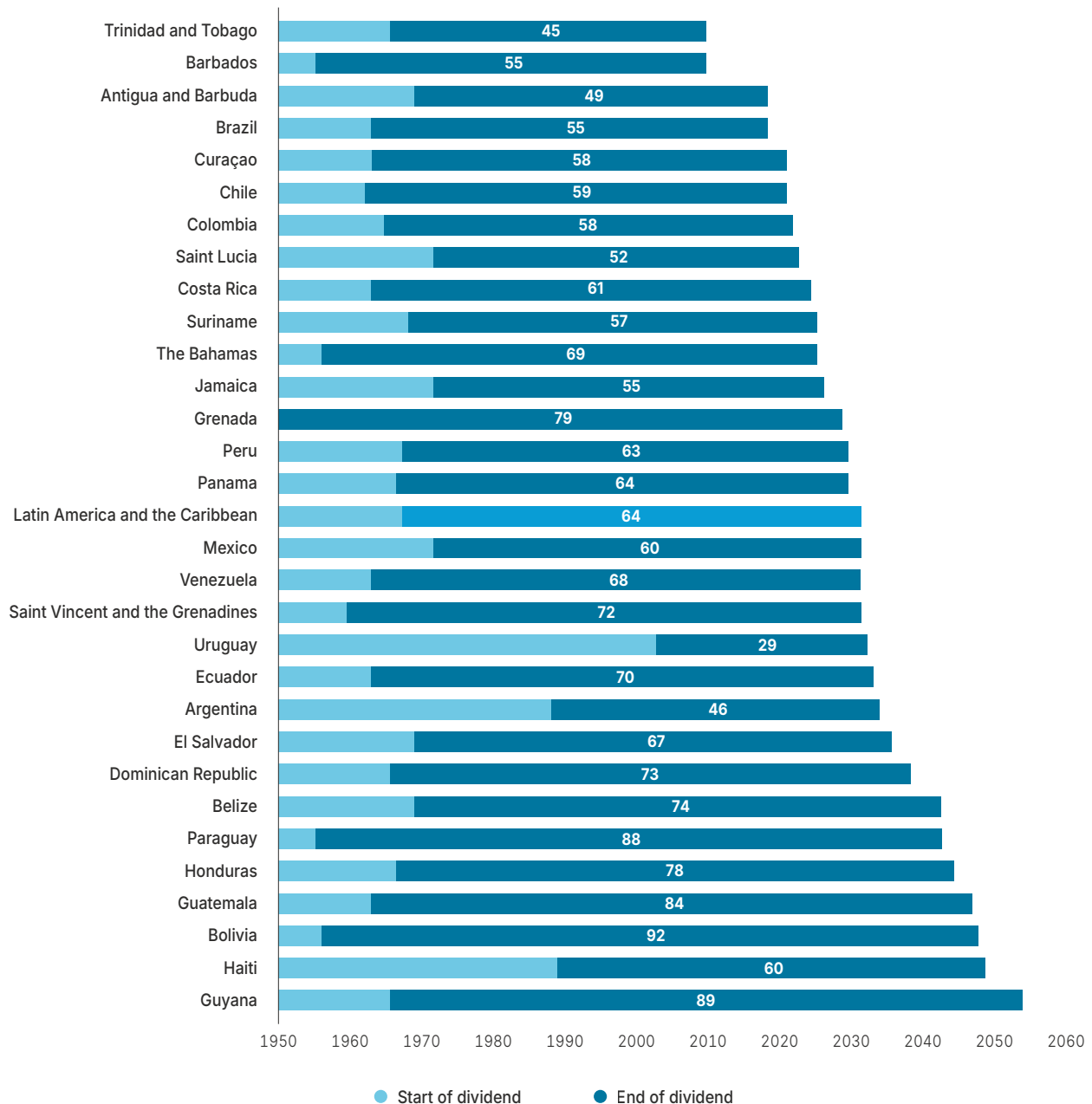


Source: ECLAC, Demographic Observatory 2022.

Note: Working age is defined as ages 15–64.

Second, despite the universal trends of population aging and declining fertility, countries in the region are at very different stages of the demographic transition. Some—such as Bolivia, Guatemala, Guyana, Haiti, Honduras, and Paraguay—still have relatively young populations and are therefore expected to continue benefiting from the demographic dividend well into the 2040s. In contrast, countries such as Barbados, Brazil, Chile, Colombia, Costa Rica, Suriname, and Trinidad and Tobago have already completed, or are in the final stages of, their demographic dividend, reflecting more advanced levels of population aging (ECLAC 2022).

FIGURE 2.47 STARTING YEAR AND DURATION OF THE DEMOGRAPHIC DIVIDEND



Source: Authors' calculations, based on United Nations (2024).

Note: The annual total dependency ratio is defined as the ratio of the population ages 0–14 and 65 and older to the population ages 15–64, using estimates for 1950–2023 and medium-variant projections for 2024–2100. For each country, the ratio is smoothed with a seven-year centered rolling average. The demographic dividend begins at the smoothed maximum ratio preceding the minimum and ends at the lowest ratio.

Third, while labor force growth is slowing, the absolute increase in the number of workers remains substantial, posing a significant job creation challenge for countries in the region. During 2020–2025, the labor force grew at an average annual rate of about 1.25 percent; however, this rate is projected to fall below 0.45 percent by the late 2040s (ECLAC 2024a). This sharp deceleration is largely driven by the contraction of younger cohorts under age 30. Nevertheless, in absolute terms, the labor force is still expected to expand by an average of 3.9 million people per year between 2022 and 2032, underscoring the continued need for policies that promote job creation and productive employment.

Fourth, population aging and rising female labor force participation have lengthened working lives in the region. Time spent in economic activity, measured as gross years of working life, is projected to increase by just over 11 years, from an estimated 33.5 years in 1980 to about 45 years in 2050. This aggregate trend masks important differences between men and women: between 1980 and 2050, gross years of working life are expected to decline slightly for men—from 51.7 to 50.5 years—largely reflecting longer time spent in education, while increasing sharply for women—from 16.7 to 39.9 years—as female labor force participation continues to rise (ECLAC 2024b). Longer working lives imply the need for sustained demand for employment opportunities across the life cycle, highlighting the importance of labor markets that can productively absorb workers of all ages. They also point to the need for continuous skill updating throughout longer careers. As discussed in Chapters 6 and 8, this reinforces the case for active labor market policies targeting older workers.

Fifth, the region is aging faster and at lower income levels than any other region in the world. Latin America and the Caribbean is growing old before growing rich, with the share of the population ages 65 and older projected to double from 10 to 20 percent in just 28 years—faster than in any other region globally. By comparison, Europe and North America—Canada and the United States—took about 60 years to reach the same demographic transition. This accelerated aging leaves the region with significantly less time and fewer resources than high-income countries to adapt its labor markets and social protection systems. When high-income countries reached a 20 percent share of the population ages 65 and older around 2025, their average GDP per capita was approximately US\$47,000 in constant 2015 US dollars. In contrast, estimates by Aranco et al. (2022) indicate that when Latin America and the Caribbean reaches the same milestone around 2055, its average GDP per capita will be only about US\$22,000.

The importance of these demographic shifts cannot be overstated. In large part, the region's past growth has been fueled by favorable demographic tailwinds. For decades, the region has relied on a consistent increase in the share of the working-age population, which made it easier for the economy to grow. However, the demographic boom is now coming to an end, and the region will need to identify new engines of growth, with productivity improvements playing a central role. At the same time, important challenges remain in absorbing a still-growing labor force. Longer working lives imply sustained demand for employment opportunities across the life cycle, highlighting the need for labor markets that can productively absorb workers of all ages. It will also be essential for these jobs to provide social protection, as pensions and other social security systems will need to support longer life expectancies.

The demographic boom that fueled decades of growth is coming to an end, and the region must now find new engines of growth.

What We Have Learned: Limited Progress, Urgent Reforms Needed

To sum up, the region has made some progress in key labor market indicators—such as real labor income, participation, and formality—but overall gains have been slow and uneven. The sluggish pace of labor productivity growth and the almost nonexistent growth of TFP are particularly concerning, especially in light of demographic trends that will reduce the working-age population and slow the expansion of labor supply.

Moreover, despite widespread perceptions that technology is rapidly transforming labor markets in the region, many core features have remained surprisingly stable. Standard wage employment continues to dominate, meaning that traditional regulations governing salaried work, such as minimum wages, remain highly relevant. Employment continues to be concentrated in small, unproductive firms, with little evidence of improvement over time.

That said, new forms of work are emerging, and regulatory frameworks will need to adapt accordingly. Increased exposure to new technologies, including AI, will also require adjustments in labor regulations and sustained investments in workforce skills.

We ask readers to keep these lessons in mind as they read the subsequent chapters. We would like to move directly to the policy solutions, which are the main point of the book, but we are not quite ready yet. So far, we have seen that jobs are of poor quality, with little evidence that the problem will be fixed anytime soon. To understand how they could be improved through better policies, we need to understand the institutions charged with these policies, which we will do in the next chapter.



3

The Foundations of Labor Policy: Why Labor Markets Fail and Policy Matters



THIS CHAPTER IN **FIVE** POINTS

- 1 Labor policy exists because labor markets are fundamentally imperfect.** Labor markets are shaped by multiple market failures—imperfect information, incomplete contracts, monopsony power, and underinvestment in skills—that justify government intervention. Without policy, outcomes would be both inefficient and inequitable.
- 2 Labor is not a standard good: regulation reflects its human dimension.** Unlike other markets, labor involves human beings, not interchangeable inputs. Employment relationships entail power imbalances and social risks, making regulation essential to protect workers and promote fairness.
- 3 Labor markets in the region are characterized by allocative inefficiency, fragmented and insufficient social protection, and inadequate skills formation.** These failures contribute to low productivity, high informality, and persistent inequality.
- 4 The region's institutional architecture—built around formal salaried employment—has provided protection for some workers but excluded many others.** It has also introduced distortions that affect hiring, productivity, and firm behavior.
- 5 The challenge of labor policy is to expand protection and strengthen human capital while minimizing distortions that hinder job creation and growth.** Improving skills development and reducing misallocation are complementary and mutually reinforcing efforts.

3.1 Labor Markets Are Key for Productivity and Inclusion: How to Ensure That They Work

Well-functioning labor markets and social protection systems are critical to sustaining economic growth and poverty reduction. Labor income accounts for 84 percent of household income in Latin America and the Caribbean and represents the main pathway out of poverty. Beccaria et al. (2011) review the events that precipitated households' exit from poverty in five Latin American countries and find that in 60 to 90 percent of cases, these transitions were associated with obtaining employment. Consistent with this, stronger labor market outcomes drove nearly two-thirds of poverty reduction in the region between 2021 and 2023 (World Bank 2024). Labor markets are also critical for sustaining growth and productivity. For instance, well-functioning labor markets facilitate the efficient allocation of workers across firms and sectors, translating into productivity gains. A central policy challenge therefore arises: how to ensure that these markets operate effectively and inclusively.

As in other markets, government intervention may be warranted in the presence of market failures that lead to inefficient outcomes, such as limited competition in the labor market, externalities associated with job separation, and information frictions. In addition, labor market regulations are also motivated by other social and equity objectives, as well as the protection of vulnerable groups.

Such interventions can have significant effects on labor market outcomes. They may substantially alter the price of labor through, for instance, binding minimum wages or large employment subsidies. They can also affect its quantity, for example through investments in skills, and shape the way labor is exchanged, for example by reducing information asymmetries or facilitating collective bargaining.

However, finding the right set of policies requires a delicate balance, since these policies can also have unintended consequences. They may create distortions that reduce productivity; constrain job creation or affect hiring practices; lead to unequal outcomes by introducing barriers for certain groups; or prove ineffective, particularly where enforcement is weak. Thus, government interventions may undermine the outcomes they seek to achieve or entail important trade-offs. A clear understanding of their origins and rationale is therefore essential and is discussed in this chapter.

3.2 Labor Markets Are Not Ordinary Markets

There is a fundamental feature—obvious to many, but often overlooked—that clearly distinguishes labor markets from most others. Labor markets concern human beings, not interchangeable goods. Labor is simultaneously a means of production and one of the main vehicles for realizing human development. As such, it has specific characteristics that make it impossible to govern through the same neutral market mechanisms that regulate the market for oranges, for example. First, unlike in other types of markets, labor is not sold but only hired through a verbal or written contract. This means that employer-employee relationships are based on implicit agreements and trust (Coase 1937; Hart and Holmström 1986). Second, employment relationships are relational and potentially conflictual. They involve authority, dependence, and repeated interactions that differ from most voluntary transactions and generate conflict over effort, hours, safety, discrimination, dismissal, and other issues. Therefore, the regulation of labor markets is always influenced by power relations and ethical considerations.

Fundamentally, there are important individual and social costs associated with the efficient functioning of labor markets. Although the efficient functioning of the labor market will necessarily imply job loss and job reallocation, and our policy recommendations regarding the regulation of dismissals will recognize the importance of this flexibility, it is also true that the loss of a job today may cause irreversible costs for individuals and society. At the individual level, present-value earnings losses associated with mass layoffs are very large and highly sensitive to labor market conditions at the time of displacement (Davis and von Wachter 2011).¹⁷ Job loss has also been associated with psychological and physical distress (Burgard, Brand, and House 2007) and significantly higher worker mortality following displacement (Sullivan and von Wachter 2009).

At the societal level, job reallocation results in an increased risk of family disruption, poorer outcomes for young relatives, and criminality (Page, Stevens, and Lindo 2009; Brand and Simon Thomas 2014; Khanna et al. 2019). These individual and social costs also translate into broader fiscal and macroeconomic externalities, which we discuss in Section 3.4.6.

The special features of labor regulation go beyond the protection of people when they change jobs. We do not fund pensions for robots, but we do design pension systems to protect workers because their well-being is inseparable from economic progress. We also do not

¹⁷ They find men lose an average of 1.4 years of pre-displacement earnings if displaced in mass-layoff events that occur when the national unemployment rate is below 6 percent, and 2.8 years if displaced when the unemployment rate exceeds 8 percent.

concern ourselves with the well-being of robots when they break down; we only repair them when it is in our economic interest to do so. We do design health care systems to attend to individuals regardless of whether they will be able to work in the future. Furthermore, unlike machines, people respond to incentives. They may work better if they feel they are treated fairly and have the right incentives, whereas machines do not need to be motivated to do what they are built to do. This human dimension has historically inspired the desire to protect labor, shaping labor and social protection institutions.

3.3 How History Shaped Today's Labor Market and Social Protection Institutions

Understanding the origins of labor market and social protection policies is important, as they are shaped not only by economic considerations but also by historical and cultural contexts. In Latin America, much of the region's labor regulation and social protection can be traced to industrial policies enacted in the first half of the twentieth century. The emergence of these institutions occurred later in the Caribbean, although a similar basic architecture emerged. During this period, state-led industrialization expanded formal wage employment, while rising social demands from skilled and organized labor movements—politically influential in key economic sectors—further shaped policy choices (Carnes 2009). These dynamics contributed to a sharp division between “insiders” and “outsiders” in labor protection (Rueda 2005), as the state sought to consolidate its political base around the emerging urban middle class (Bronstein 1997).

Labor codes in the region were largely shaped by civil law traditions and aimed at protecting organized wage workers (Botero et al. 2004). They established a strong system of employment protection legislation (EPL), including rules on contracts, dismissals, severance pay, collective bargaining, and employer obligations within the workplace. At the same time, social security systems providing insurance against health and pension risks were introduced under a Bismarckian model, named after Otto von Bismarck, who first created these employment-based, contribution-funded programs in nineteenth-century Germany. Bismarckian systems are contributory, funded by payroll contributions from employers and workers, and employment-based, linking eligibility and benefits directly to an individual's work and contribution history and therefore mainly covering workers in formal, salaried jobs. Thus, both labor codes and social security institutions emerged in parallel with different logics and

legacies but applied to the same politically organized insiders—urban, male wage workers in formal firms—and excluded wide segments of the labor force, including family, domestic, seasonal, self-employed, rural, and agricultural workers, among others.

In the English- and Dutch-speaking Caribbean, these institutions emerged later, after the wave of independence from the 1960s through the early 1980s, but they also followed a Bismarckian model for contributory social systems, financed through employer and employee contributions. Labor regulation, however, developed through common law industrial relations statutes rather than comprehensive civil law labor codes.

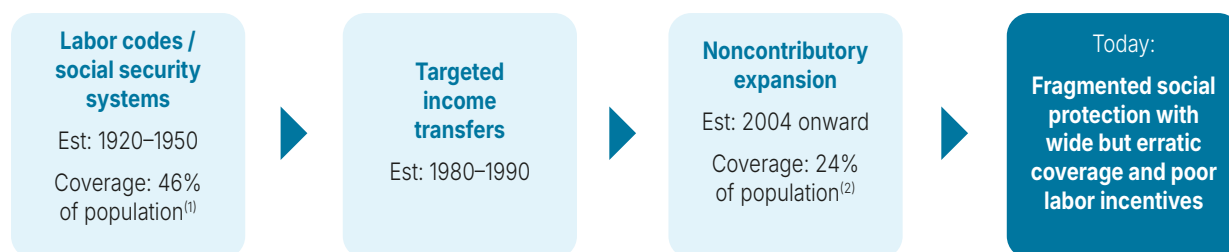
Despite some institutional differences, the underlying architecture in most countries of the region relied on a system that tied social protection to the job rather than to the individual or to a universally applied system. For example, if a person had two jobs, each employer would contribute to old-age pensions and health protection, ignoring the fact that the two jobs were held by the same person.

Social security regulation in Latin America and the Caribbean has evolved very differently from the European systems that inspired it.

Social security regulation in Latin America and the Caribbean has evolved very differently from the European systems that inspired it. The original design tried to achieve both insurance and redistribution objectives. This model was designed based on the belief that social security could redistribute income from employers to workers during economic downturns (Kaplan and Levy 2014), and on the belief that coverage would become essentially universal over time as informal employment gradually disappeared. As discussed throughout the book, coverage was, and still is, much narrower, compliance was much weaker, and collective labor relations became authoritarian and repressive, so unions had little real freedom to organize, negotiate, or strike (ECLAC 2009). In short, individual protection was strong on paper but narrowly applied, meaning that the systems were exclusionary by design. Labor institutions did replicate the formal structures of advanced economies, but without the broad coverage, stability, or social cohesion that characterized them in other contexts.

After the debt crisis and structural adjustment period of the 1980s, social policy was redefined around targeted poverty relief and fiscal restraint rather than universal insurance (Khemani et al. 2000; United Nations 2017). As discussed in more detail in Chapter 5, since the early 2000s, the region has moved toward extending coverage through noncontributory programs to the part of the population that was otherwise left behind by the Bismarckian model and targeted transfers. It introduced and, in some countries, drastically scaled up noncontributory social protection in pensions, cash transfers, and health schemes. By the 2010s, most countries in the region had at least one program that gave benefits similar to those of contributory social security to people without formal employment. Today, over 24 percent of the population in Latin America and the Caribbean is covered by at least one noncontributory benefit (ILO 2021b).

FIGURE 3.1 EVOLUTION OF LABOR REGULATION AND SOCIAL PROTECTION IN LATIN AMERICA AND THE CARIBBEAN



Source: Authors' elaboration, based on data from: (1) IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, circa 2023; and (2) ILO (2021b).

Note: Noncontributory coverage includes cash transfer programs. In the English- and Dutch-speaking Caribbean, labor regulation emerged during the independence period of the 1960s and 1980s through common law industrial relations statutes.

Consequently, today the region's typical social protection framework involves two parallel systems. Formal wage workers are covered by the Bismarckian model, while the rest of the population may receive some form of insurance through parallel programs (Levy and Cruces 2021). Putting effectiveness aside, one can say that the expansion of coverage through these two systems has been wide in much of the region. However, as will be discussed throughout the book, far less progress has been made in reforming the underlying tax, labor, and social insurance regulations that originally limited contributory coverage and that also have important negative consequences for productivity. Efforts to integrate parallel systems into a coherent framework have also been rare.

3.4 Why Market Failures Require Labor Policy

Labor markets do not function as perfectly competitive arenas where workers and firms interact under full information and frictionless conditions. Instead, a range of pervasive market failures systematically distort hiring, wage setting, skills formation, and risk sharing—often leading to inefficiencies, inequities, or both. Here we discuss the main market failures that affect labor market outcomes and the rationales for policy intervention.

3.4.1 Incomplete Contracts

A first justification arises from the fact that labor transactions typically involve incomplete contracts. This means that verbal or written agreements in a labor relation usually contain broad and unspecified tasks and ambiguous labor conditions, and are based on effort, quality, and motivation that cannot be perfectly fixed or enforced (MacLeod 2010). Moreover, employers may know little about prospective workers' productivity, and workers may know little about firms' conditions or career prospects. This creates a potential source of inefficiency in the allocation and utilization of labor. Regulations aim to address this, for example, by setting minimum working conditions or defining acceptable grounds for dismissal.

3.4.2 Incomplete or Asymmetric Information in Search and Matching

Matching workers to vacancies is often slow and costly because of search frictions, which arise because workers and employers need time, effort, and information to find suitable counterparts—what economists would classify as incomplete information, in the sense that important facts are not known to the parties. Even when jobs exist and workers are willing to work, these frictions delay the formation of employment relationships, creating periods of unemployment that stem not from a lack of vacancies or labor supply but from the inefficiency of the matching process itself (Pissarides 2000). Often the information is not only imperfect but also asymmetric, in the sense that one party has information the other does not. One example is a worker who knows their own abilities while the potential employer does not. In this case, the firm may fail to hire a well-matched worker because it cannot distinguish between a worker who has the right skills and one who is only pretending to have them.

These frictions provide strong justification for active labor market policies (ALMPs) and income support for the unemployed. By improving the flow of information, reducing search costs, and helping workers and firms identify better matches more quickly, intermediaries—such as public employment services, job portals, or private recruiters—can accelerate the hiring process. ALMPs, including job placement programs, targeted training, and wage subsidies, can further reduce mismatches by aligning workers'

skills with the needs of available jobs. Income support for the unemployed, particularly through unemployment insurance, allows workers to search more effectively by easing liquidity constraints and reducing pressure to accept the first available job, thereby improving match quality. In this way, such interventions not only shorten unemployment spells but also enhance overall labor market efficiency, increasing both employment and productivity.

3.4.3 Monopsony Power

Labor markets are often characterized by monopsony power, whereby employers have disproportionate bargaining power over workers, allowing them to set wages below the competitive level. Such labor market power arises when competition among employers is limited—either because there are few firms in the market, that is, concentrated labor demand, or because workers face barriers to mobility, such as geographic constraints, lack of information, or skills mismatches. In such settings, employers effectively face a “captive” workforce, reducing the pressure to raise wages or improve working conditions. Employers can therefore appropriate a larger share of the value generated by labor relative to workers. As discussed in more detail in Box 3.1, this is indeed the case in Latin America and the Caribbean, where workers receive wages equivalent to roughly 50 percent of what they produce, compared with 81 percent in advanced economies (Alviarez et al. 2025). There is also evidence from Peru indicating that even with widespread self-employment expanding workers’ outside options and reducing employer market power, high employer concentration substantially reduces wages (Amodio, Medina, and Morlacco 2022). Monopsonistic markets thus have clear negative equity implications.

While discussions of monopsony often focus on its equity effects, monopsony also leads to economic inefficiencies. In a monopsonistic labor market, hiring an additional worker may require raising wages for all existing employees, increasing the marginal cost of labor. For example, a firm might hire one worker at a wage of 10 who produces 25 but avoid hiring a second worker who would also produce 25 if doing so raises both wages to 20, bringing the marginal cost of the second hire to 30. These higher marginal labor costs lead firms to employ fewer workers than is socially optimal, lowering total output. Moreover, evidence suggests that monopsony power can also affect productivity by distorting occupational choices. Specifically, it may help explain the high rates of low-productivity self-employment

Workers in the region receive wages equivalent to roughly 50 percent of what they produce, compared with 81 percent in advanced economies.

in developing countries. By suppressing wages in salaried jobs, it can lead workers to underinvest in skills needed for wage employment and overinvest in those suited to self-employment (Balmaceda 2025).

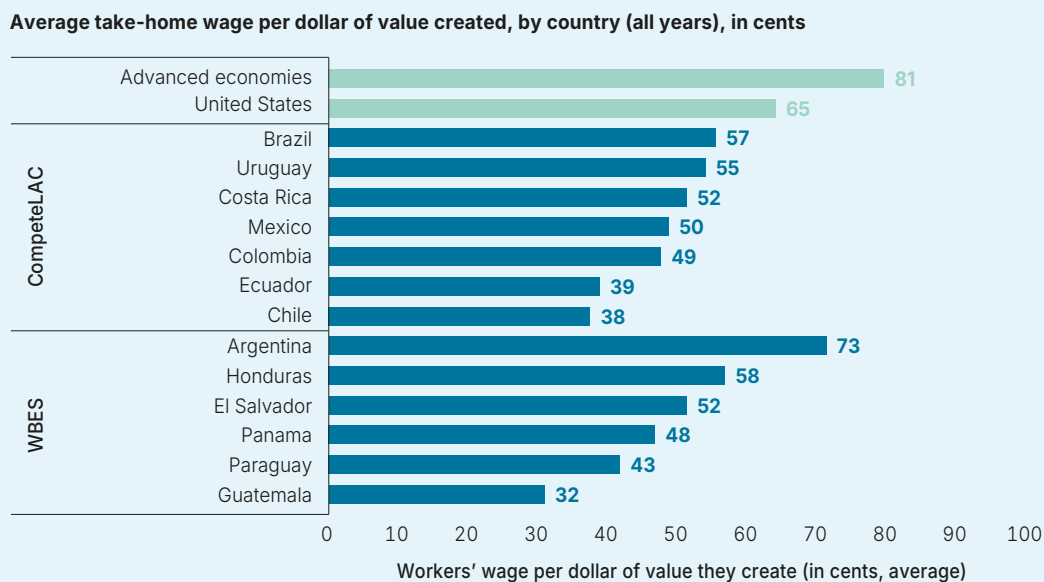
Given its implications for both equity and efficiency, monopsony power has motivated a range of policy responses aimed at shaping how wages and employment are determined in practice. These include wage-setting institutions—such as minimum wages and collective bargaining frameworks—that can influence the distribution of surplus between firms and workers. Evidence suggests that these institutions can affect not only wages but also employment dynamics: for example, research from Brazil finds that weakening unions was associated with declines in both wages and formal employment (Kohli 2024), while evidence from Norway shows that unionization can offset some of the negative effects of monopsony on wages and employment (Dodini, Salvanes, and Willen 2021). These findings highlight that, in settings where firms have wage-setting power, labor market institutions can play an important role in shaping outcomes.

More broadly, policy approaches to monopsony extend beyond wage regulation and often focus on the conditions that sustain or mitigate employer market power. Barriers to worker mobility—such as geographic constraints, limited information, or skills mismatches—tend to reinforce monopsony, while policies that expand workers' outside options can reduce market power. These include interventions that improve job matching, enhance skills portability, or reduce frictions in moving across jobs or locations. Other areas of policy, such as antitrust frameworks in product markets or investments in reskilling systems, can also indirectly influence the degree of labor market power.

BOX 3.1 FOUR FACTS ABOUT MONOPSONY POWER IN LATIN AMERICA AND THE CARIBBEAN

- 1. Monopsony power is higher than in advanced economies.** On average, workers in Latin America and the Caribbean capture only about 50 percent of the value they produce, compared with 81 percent in advanced economies. There is also substantial variation within the region, ranging from 38 percent in Chile to 57 percent in Brazil, based on comparable data from CompeteLAC (see Figure 3.2).
- 2. Monopsony varies sharply across industries.** Even within manufacturing, the share of output accruing to workers ranges from as low as 27 percent in metals to as high as 74 percent in apparel, revealing large differences in labor market power across sectors (see Figure 3.3).
- 3. Monopsony is a major drag on productivity and equity.** If labor markets in the region were as competitive as those in advanced economies, GDP per capita could increase by 25 percent, labor inequality could fall by 30 percent, and average labor income could rise by more than 50 percent.
- 4. Monopsony is stronger in larger, more productive firms—and reducing it boosts growth.** These firms tend to exert greater wage-setting power, but when monopsony declines, they expand hiring, reallocating workers from less productive activities to more productive ones. This improved allocative efficiency—also reflected in a shift from self-employment to wage employment (Balmaceda 2025)—is a key channel through which reducing monopsony raises productivity and GDP.

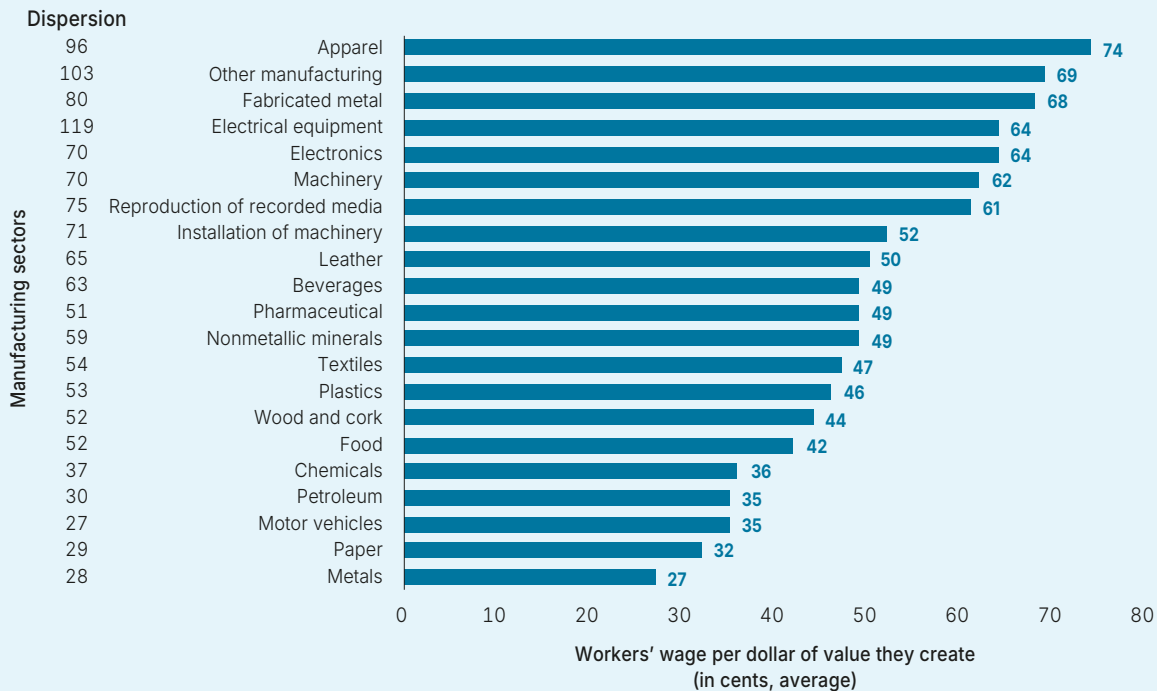
FIGURE 3.2 TAKE-HOME WAGE (IN CENTS) PER DOLLAR OF VALUE CONTRIBUTED TO FIRMS



Source: Alviarez et al. (2025).

Note: Estimates for Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, and Uruguay are based on CompeteLAC, an IDB initiative that harmonizes firm-level data to measure market competition across Latin America and the Caribbean. Estimates for Argentina, El Salvador, Guatemala, Honduras, Panama, and Paraguay are based on the World Bank Enterprise Surveys (WBES).

FIGURE 3.3 TAKE-HOME WAGE AND MARKDOWN DISPERSION BY SECTOR



Source: Alviarez et al. (2025).

Note: Countries included are Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, and Uruguay, spanning 1995 to 2022; data availability varies by country within this time frame. The figure displays the average portion of wages workers receive for each dollar of value they create in their work, calculated as the inverse of the markdown rate ($1/\mu$) for two-digit manufacturing sectors, as defined in ISIC Rev. 4. Manufacturing sectors included in the graph are those represented in at least three countries. Markdowns were estimated following the same methodology outlined in Figure 3.2. Dispersion is measured by the regional average interquartile range of markdowns.

3.4.4 Adverse Selection, Moral Hazard, and Behavioral Frictions

Given the adverse effects of job loss, it would be rational for workers to purchase insurance against the main risks they face, such as unemployment, illness, disability, and old age. However, providing private insurance for these risks is difficult without government intervention, as several market frictions make such coverage costly or unstable.

For example, adverse selection arises when high-risk individuals—such as workers in cyclical industries or with health vulnerabilities—are more likely to buy coverage, driving up premiums for everyone else. Moral hazard occurs when insured workers reduce job search effort or retire earlier, increasing costs and making insurers reluctant to offer comprehensive

protection. For instance, evidence from Mexico suggests that individuals in poor self-assessed health have, all else equal, a higher propensity to take up health insurance and that this reduces the demand for self-protection in the form of preventive care (Spenkuch 2012).

Moreover, behavioral frictions, including overoptimism, myopia, and limited financial literacy, further reduce demand, as workers underestimate their own risks and underinsure. In the case of old-age risk, people's tendency to undervalue future needs and underestimate their life expectancy leads to systematic undersaving, particularly among informal and low-income workers (Lusardi and Mitchell 2014; IDB, OECD, and UNDP 2023). Finally, aggregate risks, such as economy-wide recessions, further limit insurers' ability to diversify, making coverage costly or unprofitable.

Together, these frictions explain why private markets alone often fail to provide adequate protection, justifying public interventions such as pension systems and insurance against health shocks, disability, and unemployment. The design and labor market linkage of these policies will be a central focus of our policy recommendations.

3.4.5 Imperfections in Human Capital Investments

Finally, there are also failures in human capital investment among workers. Employers will invest in their employees based on the expected return from these investments, but in practice they cannot capture the full future returns; other employers can reap part of the benefits of that investment when the employee switches jobs. On the employees' side, bearing the full cost of human capital accumulation is often undesirable due to credit constraints (Card 1999), lack of information (Jensen 2010), or the discounting of future benefits owing to short planning horizons or job insecurity (Heckman, Lochner, and Taber 1998). This leads to suboptimal investment even when social returns are high, so workers remain underskilled relative to what firms need, which in turn makes formal jobs less attractive. This friction may justify policies such as training subsidies, lifelong learning programs, and shared-financing systems (Acemoglu 1997; Acemoglu and Pischke 1999). These problems may also justify government interventions designed to improve the human capital or skills formation process. The most obvious set of policies falls in the area of public education, although there is considerable scope for improving adults' acquisition of skills after they have left the education system.

3.4.6 Externalities Associated with Job Displacement

Another market failure that warrants government intervention stems from the externalities of job dislocation, where the dismissal of workers imposes costs on society—such as higher social spending or reduced local demand—that the firm itself does not bear (Blanchard and Tirole 2008).

While a single factory closure may appear to be a normal business cycle adjustment, widespread layoffs can create a social crisis in affected communities. At the macro level, large-scale unemployment increases the fiscal burden of compensatory programs and depresses aggregate demand, exacerbating economic downturns (Mian and Sufi 2012). These externalities provide a rationale for regulations—such as dismissal costs—that require firms generating excessive labor turnover to partially absorb the social costs of instability and encourage greater job stability. Table 3.1 summarizes the different justifications for labor and social security interventions.

TABLE 3.1 MARKET FAILURES MAY JUSTIFY INTERVENTIONS

MARKET FAILURE	EXAMPLES OF INTERVENTION
Incomplete contracts: Labor market transactions alone cannot ensure fairness or efficiency.	Incomplete contracts with asymmetric information motivate protective regulation, such as safety, dismissal, and discrimination rules.
Incomplete or asymmetric information: Employers and workers face uncertainty about productivity and job quality; additionally, search frictions delay matching.	Active labor market policies and income support for the unemployed, such as unemployment insurance.
Monopsony: Workers often have weaker bargaining power and limited mobility; some firms exercise monopsony power in local markets.	Minimum wages and collective bargaining frameworks.
Imperfections in human capital investments: Skills are built through long-term training that benefits not only firms but also society. Both workers and employers underinvest. Workers face liquidity constraints, lack of information, or short horizons. Employers face nonappropriability of investments in general skills.	Technical education and training, and regulations for apprenticeships and work-based learning programs.
Moral hazard and adverse selection: Moral hazard refers to taking more risks when protected; adverse selection refers to high-risk individuals being more likely to seek protection.	Social security programs, such as unemployment insurance and pensions.
Externalities associated with job displacement: Job dismissals create costs to society that employers do not bear.	Dismissal regulations and public funding of unemployment insurance.

Source: Authors' elaboration.

3.5 Why Have Policies and Regulations Failed to Deliver Functioning Labor Markets?

Unlike goods or capital, labor cannot be owned, stored, or simply disposed of when obsolete; it is inseparable from the human beings who supply it. This fundamental distinction has shaped how societies choose to regulate work; some degree of labor regulation is necessary to protect individuals from economic and social risks and to ensure dignity and fairness in working conditions. Yet, if labor regulation is judged by its primary purpose—providing adequate protection to workers—then most countries in the region, in practice, have introduced distortions without achieving their goal. At the same time, some degree of tension between worker protection and labor productivity is unavoidable. It is impossible to design social protection policies, whether insurance or redistribution, without inherently altering some economic incentives (Barr and Diamond 2006). The challenge is to ensure that these costs are justified by the benefits they deliver.

The next section examines why Latin America's labor policies fail to function effectively from three perspectives: distorted incentives that lead to an excessive allocation of workers to low-productivity firms, the exclusion of large segments of workers from adequate protection, and limited accumulation of productive skills.

3.5.1 Allocative Inefficiency: The Cost of Putting Workers in the Wrong Jobs

A defining feature of the region's labor markets is the fragmentation of economic activity into very small business units, which are more likely to operate informally. While small firms are not necessarily inefficient, the region exhibits substantial allocative inefficiency: labor and capital are not allocated toward the most productive firms and activities. As a result, highly productive firms often remain too small, while less productive firms employ a larger share of workers and resources than would occur under an efficient allocation. This misallocation lowers aggregate productivity and reduces economic growth (Busso, Fazio, and Levy 2012; Busso, Madrigal, and Pagés 2013; Eslava, García-Marín, and Messina 2023).

A range of policy distortions contributes to this misallocation by influencing firms' incentives to grow, formalize, and hire workers. Taxation and regulatory incentives play a central role in shaping firm size and informality. By raising the relative cost of growth, these policies make it more attractive for firms to remain small: small informal firms often face lower effective tax burdens, while larger formal firms encounter higher taxes (Azuara et al. 2019). Product and factor market regulations, together with simplified social security regimes, reinforce these

incentives, encouraging self-employment and small-scale operations even when larger, formal firms would be more productive (De Paula and Scheinkman 2010; Levy 2018; Ulyssea 2018; Fietz et al. 2025).

Moreover, as discussed in Chapter 7, labor and social security legislation further exacerbates the problem. Employer-employee contributions that fund social security and regulations that protect workers, while intended to ensure fairness, sometimes amount to 50 percent of wages and often act as implicit payroll taxes. This occurs because workers often undervalue these contributions. They may fund broad social programs unrelated to their own employment or firm, or protections that they could obtain even without contributing. To a large extent, these distortions stem from the historical legacy of the Bismarckian model described earlier, which ties social security protections to salaried employment—even for risks unrelated to the nature of the work. By design, this structure increases the relative cost of formal, salaried labor compared with informal employment or self-employment.

Excessive or poorly designed employment protection regulations can also create allocative inefficiencies. As discussed in Chapter 4, such regulations can impose very high dismissal costs, discouraging formal job creation. They can also push firms toward temporary or informal arrangements, since the costs of open-ended contracts increase disproportionately under these rules. Finally, enforcement strategies based on firm size can further amplify these effects. When enforcement intensity is focused on smaller firms, it effectively acts as a subsidy for staying small or informal. Evidence in this regard is also presented in Chapter 4.

3.5.2 Fragmented Social Protection: When Coverage Depends on Jobs

Another way labor markets fail to function efficiently is by providing insufficient levels of social protection. Workers have limited protection against labor-related shocks, such as job loss or workplace accidents. More broadly, households remain exposed to risks only loosely connected to employment, such as illness.

Social protection systems in Latin America and the Caribbean fall short of their main goal, but they are also distortionary in that they significantly affect the functioning of labor markets. Built on a Bismarckian model, the region's social protection architecture provides wide-ranging protection for formal wage workers through pensions, health care, and extensive employment protection legislation, while leaving informal and self-employed workers covered only by fragmented poverty-alleviation programs or limited noncontributory benefits. This dual structure no longer fits Latin America and the Caribbean's labor reality, where most workers move into and out of formality and self-employment over their lifetimes (Amodio, Medina, and

Morlacco 2022; Menezes-Filho and Narita 2023). Many contributors fail to meet the eligibility thresholds for pensions or unemployment insurance, and conditioning benefits on stable wage employment penalizes those with intermittent formal careers.

It is important, however, not to equate a lack of formal employment with a lack of social protection. The expansion of noncontributory social security, which offers elements similar to those of contributory social security, has dramatically increased the coverage of key elements of social protection, such as pensions and health care, especially among more vulnerable groups, including those with low levels of education who tend not to receive the protections afforded to formal workers and their beneficiaries. Yet, despite these gains, noncontributory systems still exhibit design flaws, even before considering productivity effects. Regarding health care, the fact that people move between contributory and noncontributory systems as they change jobs reduces the effectiveness of care, with negative consequences for health outcomes (Doubova et al. 2018). While noncontributory pensions may be sufficient to keep recipients out of poverty, they typically do not provide amounts considered sufficient for most workers. In sum, although noncontributory benefits have expanded access, the resulting protection remains fragmented, gap-ridden, and erratic over time for individuals (Kaplan and Levy 2014).

There is strong evidence that the fragmentation of the social protection framework into contributory and noncontributory programs, which essentially mirrors the labor market fragmentation mentioned earlier, significantly weakens the overall social protection network. Busso et al. (2020), for example, directly study social protection and informality in Latin America and highlight the limitations of fragmented systems in reaching vulnerable informal households in the face of large aggregate shocks.

Beyond being exclusionary, the model also creates economic distortions. Tying access to benefits to formal jobs forces policymakers to choose between full protection for a minority and fragmentation for all. The linking of social protection to jobs is particularly troubling in cases in which the protection would appear to be a universal right. Health care is a good example. Suppose that policymakers decide that everyone has the same right to quality health care regardless of labor status. This decision leads to the result that the employer-employee contributions used to finance the contributory pillar of health care are now pure taxes on formal employment. Along these lines, Bosch and Campos-Vázquez (2014) find that the extension of a noncontributory health program in Mexico reduced the growth of formal employment.

There is simply no way to link a universal right to the labor market without generating problems either for the labor market or for the social protection system, or both.

If, on the other hand, policymakers accept differential access to health care depending on labor market status, they have relegated a large segment of the population to lower-quality care. Furthermore, whether an individual is eligible for a given service will depend on whether the individual happens to require that service when they have a formal job. The same service that is covered today will be denied next year due to the normal process of job rotation. There is simply no way to link a universal right to the labor market without generating problems either for the labor market or for the social protection system, or both. Of course, the option exists to simply not link the protection to the labor market, for example, through a health care system financed by general taxation with equal access for all, which is the option we will recommend in Chapter 8.

In summary, linking benefits to the labor market with the intention of attaining universal coverage is problematic on multiple fronts. This linking simultaneously generates high nonwage labor costs that reduce productivity by promoting allocative inefficiency and creates social protection schemes that are fragmented at any given moment and erratic over time for an individual.

The above argument does not apply to the protection of risks inherently related to the labor market. Consider, for example, accident insurance. Contributions for accident insurance can finance a benefit that those workers would not receive in the absence of the contributions, namely protection against on-the-job accidents. Someone who does not work, for example, simply does not need such protection. Furthermore, to the extent that firms with higher probabilities of accidents pay higher premiums, those higher premiums act as an instrument that internalizes the negative externality of high accident rates. The appropriate design of social protection therefore depends on the nature of the risk, a principle that underpins many of the policy recommendations in this book.

3.5.3 The Skills Gap: When Talent Does Not Meet Demand

Improving productivity and equity outcomes in the region requires more than better allocation of labor across firms; it also depends critically on the level of skills workers bring to the labor market. Low productivity reflects not only allocative inefficiencies but also inefficiencies arising from weak skills and inadequate training. As discussed in Chapter 6, these challenges are substantial: the region faces large deficits in foundational skills and persistent mismatches between the skills workers possess and those demanded by jobs.

Addressing these gaps can yield large returns. Haanwinckel and Soares (2021), for example, show that improvements in the educational composition of the labor force were the main driver behind the sharp decline in informality in Brazil between 2003 and 2012. More recent evidence from Colombia by Alfaro et al. (2025) compares policies that invest in human capital with those that reduce misallocation by removing distortions. While reforms that reduce firm-level and regulatory distortions—such as size-dependent regulations or minimum wage policies—can increase incomes and reduce inequality, investments in human capital appear to have much larger effects in generating good jobs and improving equity outcomes.

Addressing these challenges requires a life-cycle approach to skills formation. Skills begin to develop in early childhood but continue to evolve throughout adulthood. Importantly, this latter stage is becoming increasingly relevant in the current demographic context. As discussed in Chapter 6, population aging implies that the existing stock of workers will be more slowly renewed by younger cohorts, while longer working lives increase the need for continuous skills upgrading.

However, as discussed in Chapter 6, the region's skills formation systems remain weak. Technical and vocational education and training (TVET) systems are under-resourced and often lack the institutional capacity to address key market failures. Provision is fragmented, with limited coverage of workers at the margins of the labor market and weak access to financing for training. Coordination and governance problems further reduce effectiveness, making it difficult to align program content with evolving firm demand. Moreover, workers in the region accumulate far less human capital on the job than workers in advanced economies (Jedwab et al. 2023). Human capital formation during working life is often intermittent, with relatively little structured learning or upgrading by international standards. This reflects the region's low-productivity environment and the prevalence of small firms, which typically have limited capacity to provide systematic training or internal career ladders. As a result, skill formation is constrained both externally, by weak training systems, and internally, within firms, limiting workers' productivity growth over the working life cycle.

3.6 Developing Skills and Reducing Labor Misallocation Are Complementary Efforts

As the preceding sections have shown, labor misallocation is indeed a major constraint on productivity and job creation and is, to a large extent, derived from the design of labor protection and social security systems. Nevertheless, low labor productivity is also fundamentally driven by insufficient human capital. A lack of skills and talent limits the economy's ability to grow and generate good-quality jobs and may represent an even more powerful constraint on development.

Recent evidence is consistent with this view. As discussed earlier, an analysis of the drivers of long-run development and job creation in Colombia suggests that reducing misallocation by easing labor market distortions—such as minimum wages or payroll taxes—can generate significant gains in aggregate income and employment. At the same time, however, human capital investments are an even more effective driver and can have substantially larger impacts on aggregate income, job creation, and inequality reduction (Alfaro et al. 2025).

This calls for a dual agenda that aims to invest in workforce skills and reduce allocative inefficiency. Importantly, there is no policy trade-off between these priorities. In fact, the two objectives can be mutually reinforcing.

López-Calva and Levy (2016), for example, find that distortions that misallocate resources toward lower-productivity firms prevent Mexico from taking full advantage of its human capital investments. In Peru, policies aimed at improving worker skills increase labor income by 40 percent less than they would without monopsony distortions (Amodio, Medina, and Morlacco 2022).

Ultimately, improving labor market outcomes requires tackling both constraints simultaneously. Investments in skills will yield limited returns if workers are employed in distorted, low-productivity environments, while reducing misallocation will have muted effects if the workforce lacks the capabilities to take advantage of better opportunities. As emphasized throughout the book, sustained gains in productivity and equity depend on jointly strengthening human capital and improving the allocation of labor across firms.

3.7 The Central Challenge: Making Labor Policy Work for Inclusive Growth

The ultimate objective of labor market institutions is clear: to provide the necessary conditions for the creation of quality employment. To achieve this, labor institutions need to fulfill a dual mandate: ensuring the efficient functioning of labor markets through optimal resource allocation, while also protecting and empowering the most vulnerable, who face structural disadvantages in the labor market.

This requires action on two fronts. The first is to expand access to effective protection while minimizing the unintended distortions and exclusions that undermine productivity and growth; the second is to foster human capital investment that raises worker productivity and earnings. Without the first, the benefits of the second will be limited: protection and productivity must advance together to make labor policy a true pillar of inclusive growth. Furthermore, the design of the social protection framework currently imposes large costs on the hiring of formal workers, making it crucial for policymakers to reverse these negative effects.

Some of the best reforms for the labor market may not be labor reforms. A health reform that eliminates fragmentation and finances the system with general revenue instead of relying on social security contributions can promote formal and productive jobs. A reform that shifts the financing of family allowances or poverty-alleviation programs from social security contributions to general taxation can also improve labor market performance. Of course, labor law and institutional reforms also matter, for instance, when they remove provisions that raise the cost of employment without translating into benefits that workers value highly.

More broadly, labor market policy analysis requires greater sophistication. Too often, policy recommendations are grounded either in a simplified view of a perfectly competitive labor market—treating labor as if it were indistinguishable from capital—or, at the other extreme, in a view that assumes labor outcomes can be improved simply by adding legal entitlements, with insufficient attention to incentives and constraints. As this chapter has shown, labor markets are shaped by multiple market failures, and workers are not homogeneous inputs. Policy changes affect the decisions of both firms and workers, and well-intentioned interventions can generate unintended consequences when design is poor or incentives are misaligned.

Too often, policy recommendations are grounded either in a simplified view of a perfectly competitive labor market—treating labor as if it were indistinguishable from capital—or, at the other extreme, in a view that assumes labor outcomes can be improved simply by adding legal entitlements.



4

Making Labor Regulation Work: Incentives, Protection, and Enforcement



THIS CHAPTER IN **FIVE** POINTS

1 **Employment protection legislation is a stable and politically sensitive pillar of labor regulation.**

Its strictness varies across countries, but reform is universally difficult, often requiring legal or constitutional changes. As a result, despite evidence of trade-offs between productivity and job access, the regulatory landscape has changed little in recent years.

2 **Minimum wages have risen across Latin America over the past two decades but remain unevenly enforced and can negatively affect formal employment.**

Their design and setting mechanisms vary across countries, and in some cases they reach relatively high levels. Although politically popular, the evidence shows mixed effects, including unintended consequences for formal jobs. Noncompliance is widespread: 37 percent of salaried workers earn below the minimum wage, more than twice the global average.

3 **Regulation of nontraditional labor, especially platform work, is advancing through diverse country approaches.**

Platform work remains small—about 1.5 percent of workers use it as their main job—but is increasingly important as secondary income. It is hard to regulate because pay, task allocation, and schedule flexibility are often algorithmically determined and vary across platforms. Recent reforms increasingly focus on social protection and algorithmic transparency, though enforcement remains challenging.

4 **Despite relatively strict legal frameworks, labor regulation is weakly enforced.**

The region has far fewer inspectors per worker than advanced economies, makes limited use of technology, and relies mostly on reactive inspections. This contributes to weak and uneven enforcement, especially outside large formal firms. As a result, new labor regulations are often aspirational: labor markets are heavily regulated, but enforcement resources are scarce.

5 **Organized labor remains important but relatively weak in Latin America, with declining membership.**

Union density averages around 10 percent, compared with about 30 percent in high-income countries; only a few countries, such as Uruguay and Argentina, exceed 20 percent. Collective bargaining coverage is uneven, and union density has declined in most countries, except Brazil and Chile, due to decentralized bargaining, lower manufacturing employment, and more temporary contracts. Confidence in unions has also fallen, although most people still view them as important for worker representation.

4.1 Regulating Employer-Employee Relations

Labor market regulation is often justified by the presence of market failure. This chapter examines the core set of regulations that govern the relationship between wage workers and their employers—such as collective bargaining frameworks, termination conditions, mandatory labor benefits, and minimum wage floors—and documents how they have evolved in the region over the past two decades as well as what the most recent evidence shows about their impacts. It also analyzes how the emergence of nontraditional work arrangements, such as platform work and telework, has pushed several countries to revisit the legal definition of “employee” or reassess which protections should extend to workers outside standard employment contracts.

Overall, these regulations aim to strengthen the bargaining position of wage workers and improve their working conditions. This objective is grounded in the understanding that workers typically have less bargaining power than employers for at least three reasons. First, most workers cannot endure long periods without income because of liquidity constraints and household dependence on earnings. As a result, job seekers often accept less favorable employment conditions under financial pressure, while firms typically have greater flexibility in the timing of hiring decisions. Cases in which employers face urgent staffing needs or compete for highly specialized skills are the exception rather than the norm. Second, information asymmetries and search frictions undermine workers’ negotiating position. Workers have limited information about alternative jobs (Jäger et al. 2024; Cullen 2024), and high search costs prevent them from fully capturing the benefits of outside options. Consequently, they often accept offers that reflect constrained rather than fully informed choices among alternative opportunities (Azar and Marinescu 2024). Third, market concentration gives employers monopsony or oligopsony power (Armangué-Jubert, Guner, and Ruggieri 2025). Market power is also reinforced by a high degree of job differentiation, for example, when workers have heterogeneous preferences for jobs due to geographic distance or commuting constraints. Such geographic differentiation increases employers’ ability to exercise market power over wages and working conditions (Azar and Marinescu 2024).

These regulations aim to strengthen the bargaining position of wage workers and improve their working conditions.

The consequences of these unequal bargaining positions are substantial. Most directly, workers may accept unfavorable conditions, including wages below their marginal product. As discussed earlier, there is clear evidence of this in the region: on average, workers in Latin America and the Caribbean receive wages equivalent to only about half of the value they generate (Alviarez et al. 2025). This gap has important implications for inequality and motivates policy intervention. Differences in labor market power across firms generate wage dispersion that productivity differences alone cannot explain, thereby weakening the link between pay and performance. Thus, labor market power can play a central role in shaping inequality by affecting both the labor share of income and the distribution of wages (Eslava, García-Marín, and Messina 2023).

Unequal bargaining power also affects dimensions beyond pay. Workers with limited negotiating leverage are more likely to face poor working conditions, including exposure to occupational hazards. Workplace accidents remain unacceptably frequent in the region and impose significant social and economic costs, including loss of life, long-term disability, and reduced productivity. In countries such as Mexico and Brazil, fatal occupational injuries continue to represent a nontrivial burden: annually, 3,400 to 4,600 workers suffer fatal injuries in these two countries alone. In addition, nonfatal injuries can take a heavy toll, affecting more than 500,000 workers in Colombia, 340,000 workers in Argentina, and more than 800,000 workers in Brazil each year, thus underscoring persistent gaps in prevention and enforcement.¹⁸ Moreover, unequal bargaining power can exacerbate discrimination based on sex, race, ethnicity, religion, or migration status, as workers with fewer outside options are less able to challenge discriminatory practices or exit abusive employment relationships.

These considerations provide a strong equity- and safety-based justification for regulations that help rebalance power between workers and employers. Importantly, such regulations should not be viewed as inherently detrimental to productivity. On the contrary, when well designed and effectively implemented, labor market institutions can improve both productivity and working conditions. As discussed in Chapter 3, by addressing labor market imperfections such as information asymmetries, incomplete contracts, and unclear employer responsibilities, they can enhance efficiency. For instance, by reducing wage markdowns, they can increase employment and, by limiting excessive variation in markdowns across firms, they can improve the allocation of labor to its most productive uses.

18. Authors' calculations, based on data from the International Labour Organization (ILO) and IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Nevertheless, as discussed in the remainder of this chapter, labor market institutions in the region often fall short of these objectives, and this pattern has changed little over recent decades. As the discussion shows, these shortcomings reflect not only design flaws that limit the effectiveness of regulations but also the state's limited capacity to enforce the rule of law.

4.2 Employment Protection Legislation in Practice

There is a wide array of contractual arrangements to exchange labor in the modern economy. These arrangements range from traditional, full-time, open-ended contracts that define a clear employer-employee relationship with direct oversight and control to more flexible service exchange arrangements, such as fixed-term or freelance contracts. One key area of labor legislation, commonly referred to as employment protection legislation, encompasses the laws and regulations that govern the types of employment contracts allowed and the hiring and dismissal practices. The intended goals are to promote job stability for workers, provide income protection upon termination, protect workers from unfair dismissals or discriminatory practices, and offer clear mechanisms that allow firms to adjust the size and skills of their workforce according to changes in demand.

Countries in the region place great value on these measures. In 2015, 10 of 18 Latin American countries included special provisions for monetary compensation upon dismissal, such as severance payments, in their constitutions.¹⁹ Also, 3 of 18 countries included specific constitutional provisions enabling the reinstatement or rehiring by firms of workers dismissed without cause. By contrast, no non-Latin American member of the OECD—not even those members that provide for substantial severance pay—has these provisions in its constitution (Alaimo et al. 2015). These regulations can be grouped into three main categories: rules governing contractual relationships, dismissal provisions, and special protections for groups of workers who may face greater risks of discrimination or unfair treatment (e.g., pregnant women, racial minorities, and pre-retirement workers). Each is described in detail in the sections below.

¹⁹ Legally, a constitution is the fundamental and supreme norm of a state, standing at the top of the hierarchy of laws. All other provisions—statutory, regulatory, or administrative—derive their validity from it and must conform to its mandates. Given its special character, a constitutional amendment usually requires much more complex procedures than ordinary legislation.

While employment protection legislation is clearly justified by the need to protect workers from arbitrary actions and ensure compliance with fundamental rights (i.e., the freedom to pursue a chosen occupation, the prohibition of discrimination, equality before the law, and freedom of association), there is a legitimate concern that it may at times be counterproductive.

Many studies examine the impact of employment protection legislation on labor productivity. Theoretically, the effects are ambiguous. By promoting job security and discouraging unfair dismissals, these laws can foster long-term employment relationships that can increase productivity. Employers have greater incentives to invest in employee training and skill development, and employees, in turn, are more likely to be committed and motivated, so the result is higher morale, reduced turnover, and increased efficiency. Furthermore, a fair and predictable legal framework reduces the time and resources spent on disputes, thereby allowing businesses to focus on their core operations and innovation. Ultimately, these regulations can correct labor market imperfections such as asymmetric information, unequal bargaining power between workers and employers, and the absence of adequate risk-pooling mechanisms in the labor market.

On the other hand, strict employment protection legislation can also have important drawbacks. Excessively stringent dismissal rules may discourage firms from hiring, particularly for permanent positions, while limited contractual options can make it difficult to employ workers for tasks that are inherently temporary or seasonal. Significant evidence exists of these unintended consequences (Holzmann et al. 2011; Eslava et al. 2014; Scarpetta 2014; Kuddo, Robalino, and Webber 2015; Castellani, Lotti, and Obando 2017). These unintended consequences of well-intentioned regulations designed to protect specific groups may ultimately restrict their access to employment. For example, strong dismissal protections aimed at safeguarding workers with disabilities may inadvertently discourage firms from hiring them in the first place. And, at the aggregate level, rigid regulations can hinder worker mobility and reallocation, both of which are essential for productivity growth. These impacts can take place even in contexts in which employers have monopsony power.

Moreover, when compliance is costly and enforcement capacity is limited, firms may attempt to circumvent this legislation, leading to a segmented labor market in which a small group of formal workers enjoys strong protections, while others—such as the young, women, or informal workers—are left out. Segmentation may also emerge across firms, for smaller employers often struggle to meet regulatory requirements.

Thus, it is important to examine the stringency of employment protection laws, but it is equally critical to consider the uncertainty surrounding their application. This uncertainty can arise from unclear legal provisions or inconsistencies and inefficiencies in judicial procedures

(see Kaplan and Sadka 2011). A case in point is the regulation on dismissing workers with disabilities in Colombia. Introduced in 1997 with the well-intentioned goal of protecting job stability, the regulation established special provisions for employment termination, even when there is just cause. However, legislative ambiguity and contradictory court interpretations have created significant uncertainty. In practice, this uncertainty has led labor inspectors to refrain from authorizing terminations. A study based on interviews with employers and labor lawyers found that, in general, the lack of clarity and the substantial difficulties involved in ending such contracts strongly deter the hiring of persons with disabilities (Lermen, Martínez, and Parra 2013).

4.2.1 The Role of Employment Contracts

Labor regulations typically include measures governing the types of employment contracts that can be used and how they differ in terms of job security and benefits. Full-time, open-ended contracts generally provide the highest level of protection, including social insurance coverage, employer obligations to justify termination, and, importantly, severance payments upon termination by the employer. To prevent misuse, such as using successive fixed-term contracts to avoid recognizing long-term employment relationships, legislation sets limits on renewals and their duration and, in some cases, also requires employers to justify their use (ILO 2019).

A sample of eight countries of the region illustrates how these regulations vary across countries (Table 4.1). For instance, the time limit of each temporary contract can vary from six months in Uruguay to five years in Argentina, Peru, and Paraguay, and not all countries place limits on the number of renewals. In Chile and Argentina, when there is more than one renewal, a contract automatically becomes indefinite.

TABLE 4.1 EMPLOYMENT PROTECTION OF TEMPORARY CONTRACTS

COUNTRY	MAXIMUM NUMBER OF SUCCESSIVE RENEWALS	TIME LIMIT FOR EACH CONTRACT
Argentina	1	5 years
Chile	1	1 year
Colombia	No limit	4 years
Costa Rica	No limit	1 year
Mexico	No limit	No limit
Paraguay	No limit	1–5 years
Peru	No limit	5 years
Uruguay	Based on collective agreements by sector	Based on collective agreements by sector

Source: OECD and IDB (2019).

Note: In the case of Colombia, Law 2466 of 2025 introduced the provision that fixed-term contracts may have a maximum duration of four years, including extensions. Once this period has been exceeded, the contract will be deemed an open-ended contract. In Uruguay, there is no statutory regulation, so rules are based on collective agreements and jurisprudence.

The manner in which this legislation translates into reality varies widely. As seen in Chapter 2, countries differ widely in their share of temporary compared with indefinite contracts, with countries such as Bolivia and Peru having 25 percent or fewer workers with this type of contract, and Argentina having more than 70 percent.

The use of various types of labor contracts has significant implications for worker protection. While greater stability often leads to better termination provisions, it also has important effects on productivity. Temporary contracts can enhance flexibility by enabling firms to hire workers when needed and to adjust their workforces easily in response to changing conditions—an advantage that is particularly relevant for small or liquidity-constrained firms. When well designed, such contracts can also serve as screening devices or stepping-stones to permanent employment. For instance, empirical evidence from Colombia shows that legislation lifting restrictions on the use of fixed-term contracts led to higher aggregate productivity in the manufacturing sector, particularly among firms with relatively low skill requirements (Eslava et al. 2014).

However, temporary contracts can also pose disadvantages for firms that require longer employment relationships. Heavy reliance on them can hinder human capital accumulation, as firms are less willing to invest in training and on-the-job learning for workers with high turnover. Worker effort may also be affected: temporary workers may be less inclined to exert the same level of effort as permanent employees when there are limited prospects for contract

renewal or transition to a permanent position. Suggestive evidence supports these concerns. A study of Colombia's manufacturing sector finds that temporary workers contribute less to plant-level labor productivity than permanent workers and that this gap is not explained by differences in skill composition, pointing instead to lower effort (Castellani, Lotti, and Obando 2017). Complementary evidence from Spain shows that temporary workers exert greater effort when the probability of conversion to a long-term contract is higher. These findings imply that increasing the likelihood of a transition from temporary to permanent contracts can raise total factor productivity (Dolado and Stucchi 2008).

Importantly, in many countries, temporary contracts are not used primarily as tools for flexibility but, rather, serve to reduce the labor costs associated with labor market regulations. For instance, in Peru, where the vast majority of formal labor contracts are fixed-term, the fact that only 7 percent of fixed-term contracts are converted into permanent contracts suggests that this is rarely a stepping-stone to more permanent labor (Jaramillo and Campos Ugaz 2023).

Only 7 percent of fixed-term contracts in Peru are converted into permanent ones, suggesting this is rarely a stepping-stone to more permanent labor.

Firms may also circumvent the law by relying on civil or commercial temporary contracts to evade the obligations associated with labor regulations. In Colombia, for instance, this practice has become widespread and a major source of labor disputes (Ramírez Bustamante 2021). Another common strategy to circumvent obligations is subcontracting (outsourcing) employment, whereby workers are formally employed by one firm but, in practice, work for another. International evidence indicates that this strategy affects workers' outcomes. Thus, Goldschmidt and Schmieder (2017) find that outsourcing reduces wages by 10 to 15 percent in Germany; Drenik et al. (2020) find that outsourcing reduces workplace-specific wage premia by 51 percent in Argentina; and Dube and Kaplan (2010) find outsourcing penalties of 4 to 7 percent for janitors and 8 to 24 percent for guards.

When regulatory avoidance, rather than the nature of the employment relationship, drives contractual choices, efficiency and productivity are undermined. A central objective of regulations governing contractual arrangements should therefore be to minimize the misuse of contracts, both by closing opportunities for evasion and by reducing the incentives to evade. As discussed in Chapter 8, Mexico's recent reform regulating outsourcing illustrates this approach: it not only closed key loopholes through which firms avoided labor obligations but also realigned incentives, with generally positive results.

4.2.2 Dismissal Provisions: Coverage and Limitations

Labor legislation also establishes specific procedures for contract termination, including advance notice periods, valid grounds for dismissal, and entitlements to severance or redundancy payments. Grounds for dismissal are generally legally justified when based on serious misconduct or unjustified absenteeism and due process is followed. They are unjustified when they lack legal grounds, are discriminatory or retaliatory, or violate procedural or proportionality rules. Remedies typically include severance pay or reinstatement.

These dismissal provisions are often grounded in a range of policy objectives. First, they are sometimes implemented to limit the negative social externalities associated with job loss (Blanchard and Tirole 2010), particularly in collective dismissals or industries with high turnover. Second, dismissal provisions can also reinforce equal treatment and nondiscrimination in the workplace, which are central principles of modern labor law and international labor standards. These principles include protecting workers from being dismissed based on race, sex, age, sexual orientation, disability, political opinion, or other prohibited grounds. Third, dismissal protections are often intended to provide income security by helping workers manage periods of unemployment. Finally, they are sometimes viewed as a means to promote labor productivity, based on the belief that stable, long-term employment relationships can foster trust, cooperation, and investment in training.

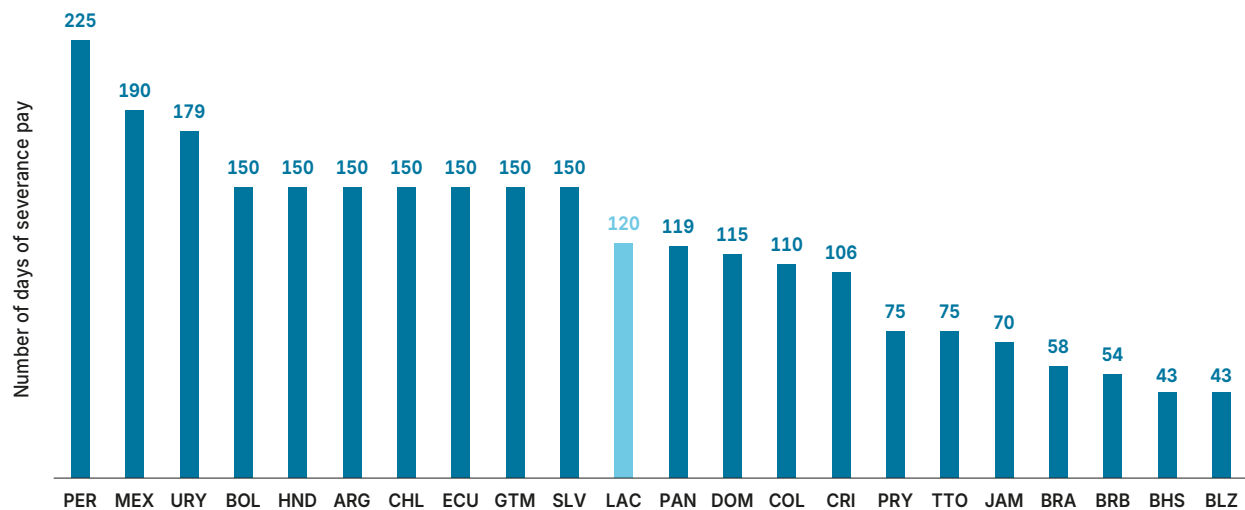
Severance payments are the most common form of dismissal protection, both in the region and globally. They may also be the provision that places the greatest financial burden on employers. These payments consist of a lump sum that is typically linked to the workers' seniority. Figure 4.1 illustrates the significant variation in severance pay across the region for workers with five years of tenure. Importantly, eligibility for severance pay often depends on the nature of the employment contract. In many jurisdictions, employees under fixed-term contracts are not entitled to severance pay. There are, however, exceptions; for instance, in Colombia, employees with fixed-term contracts are entitled to a severance payment, the value of which is linked to the duration of the contract that remains pending at the time of termination. There are, however, exceptions; for instance, in Colombia, employees with fixed-term contracts are entitled to a severance payment, the value of which is linked to the duration of the contract that remains pending at the time of termination.

On average, the severance pay for workers dismissed after five years of tenure is about 120 days of their daily wage, but workers may receive more than 150 days depending on national policies. This form of pay typically represents a labor cost of around 7.5 percent of the average annual wage of a formal employee (Alaimo, Altamirano, and Minaya 2026). By contrast, countries with more diversified income-protection systems rely far less on severance

pay as the main dismissal protection instrument. For instance, in Germany, a worker with five years of tenure receives an average of 55 days of severance payments, and such a worker in France receives up to 28 days.²⁰

The highest severance payments for workers with five years of tenure are found in Peru, Mexico, and Uruguay, while Caribbean nations generally have the lowest severance pay on average (Figure 4.1). However, in some countries, severance pay is subject to statutory caps that limit total compensation regardless of tenure. For example, in Uruguay, the maximum entitlement is six months of salary for workers with more than five years of service. As a result, while severance payments in these systems appear generous for workers with shorter tenure, they become comparatively less so for those with longer tenure (e.g., 10 years or more).

FIGURE 4.1 AVERAGE SEVERANCE PAY ACROSS LAC (NUMBER OF DAYS) FOR A WORKER WITH FIVE YEARS OF TENURE, 2025



Source: Authors, based on data from Alaimo, Altamirano, and Minaya (2026).

Notes: (1) In Mexico, dismissals are justified only when workers, in the course of their employment, are guilty of a dishonest or dishonorable act, have a physical or mental disability, or are otherwise manifestly unfit. (2) Brazil's system is pre-funded severance: instead of paying everything at the end, firms continuously contribute to *Fundo de Garantia do Tempo de Serviço* [Length-of-Service Guarantee Fund] accounts and only add the 40 percent penalty when they dismiss a worker without cause (approximately 58 days).

²⁰. Source: OECD Employment Protection Legislation (EPL) Database for Germany and France; see the country notes.

Despite widespread recognition of its limitations, severance pay has proved to be a remarkably persistent and difficult-to-reform instrument.

Severance pay regulation has remained unchanged in almost all countries in the region except Belize (Appendix 5). Despite its stability and widespread use, it is a flawed mechanism for both income protection and labor market efficiency. First, given that benefits are tied to tenure rather than actual need (e.g., the duration of unemployment or a worker's financial vulnerability), severance pay does not effectively ensure income security. Second, severance pay is frequently not delivered in practice, as firms are typically not required to pre-fund these obligations, and systems can be too focused on judicial confrontation. These conditions can result in delays or nonpayment owing to insufficient liquidity at the time

of dismissal and, in some cases, may even lead to firm insolvency. Third, dismissal regulations can drive contractual distortion, with overly rigid dismissal laws for permanent workers creating strong incentives to avoid permanent contracts altogether. For instance, evidence from Spain shows that adjustments to dismissal costs and payroll taxes for permanent contracts can increase the share of open-ended employment (Kugler, Jimeno, and Hernanz 2003).

Unsurprisingly, severance pay has been the subject of numerous analyses, which have consistently highlighted its shortcomings (e.g., Vodopivec and Holzmann 2012; Alaimo et al. 2015; Asenjo and Pignatti 2019; ILO 2021a; World Bank 2022). These concerns—also raised in previous IDB publications—remain valid. However, despite widespread recognition of its limitations, severance pay has proved to be a remarkably persistent and difficult-to-reform instrument.

In addition to severance payments, another key dismissal regulation is the requirement for advance notice periods, which specify the amount of time before dismissal that an employer must notify an employee. The logic is to give workers time to adjust to what is likely a significant income shock. However, from the employer's perspective, long notice periods can represent a significant firing cost since they may require continued wage payments for labor that is no longer needed.

The average severance pay for redundancy dismissal and the average notice period for redundancy dismissal have remained largely unchanged throughout the twenty-first century. The only exceptions are reforms in Belize, Brazil, and Barbados that increased notice periods: Belize increased the notice period from three to five weeks, Brazil from four to seven weeks, and Barbados from zero to four weeks (Appendix 5).

Some countries also define provisions beyond severance pay in cases of unfair dismissal. For example, in Peru, a 2002 Supreme Court ruling allows private sector workers who are unfairly dismissed to choose between receiving severance pay and being reinstated to their positions. Reinstatement is also included in the labor legislation of several other countries, including Honduras, Bolivia, Panama, Paraguay, and Mexico; all these provisions were introduced more than a decade ago.

Additionally, there are provisions aimed at expediting the resolution of labor conflicts. In Mexico, for instance, the 2012 labor reform introduced a cap on compensation for unfair dismissal cases disputed in labor courts. Specifically, the reform limited to one year the total amount of lost wages, plus interest, that an employer would have to pay to a worker when a court rules a dismissal unjustified. Prior to this reform, the absence of such limits created incentives to prolong disputes that made the cost of dismissal excessively high. Of course, ideally, labor disputes would be resolved as quickly as possible to minimize the costs and uncertainty for both workers and firms. In such a scenario, the one-year cap on lost wages would likely become irrelevant in practice. The more recent labor reform of 2020 also aims to speed up the dispute resolution process, with revamped pre-trial conciliation procedures and more efficient processes in the newly created labor tribunals, although evaluations have not yet confirmed the law's efficacy.

4.2.3 Special Protections for Vulnerable Workers: Fixing Targeted Policies

Protection against Dismissals for Vulnerable Workers

Additionally, most countries provide special protection against dismissal for certain demographic and social groups, such as pregnant women and worker representatives. Out of a sample of 20 countries in the region, 18 have an option for reinstatement for specially protected workers, such as pregnant women, recent mothers, and trade union members, or, more generally, in cases of dismissal on prohibited grounds such as discrimination (by race, sex, religion, or age) (Appendix 4). Special protection is also common in Europe, Asia, and Africa for workers on temporary leave because of occupational hazards or work injuries and for those performing public functions.

Only three countries in Latin America and the Caribbean (Chile, St. Lucia, and Venezuela) protect older workers and individuals with disabilities, so such measures are less common. The aim of these safeguards is to prevent unfair dismissal resulting from retaliation or

discrimination. However, enforcement can be challenging when state capacity is limited, and, as discussed in Chapter 6, such protections may have unintended consequences, such as reducing employers' incentives to hire the very populations they are meant to protect.

Family Leave: Care Protected, Burden Unshared

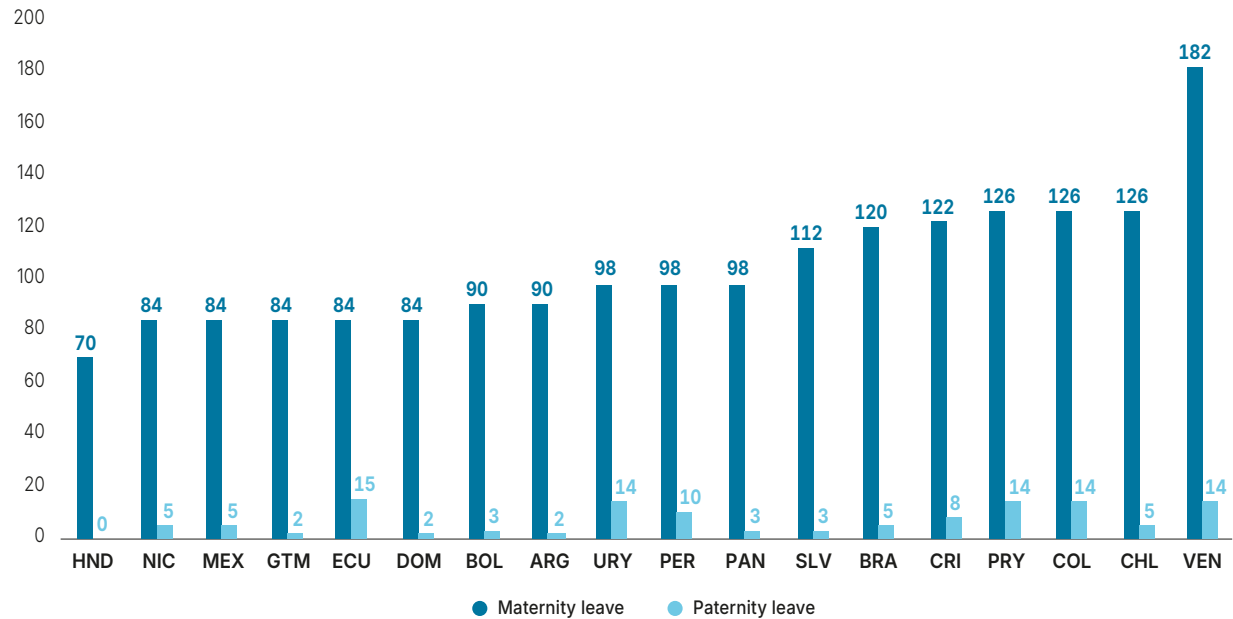
Family leave systems (such as maternity, paternity, or parental leave) include several types of job-protected leave that enable workers to care for newborns or family members. Paid maternity leave is the most common form of family leave. Across Latin America and the Caribbean, 26 countries provide paid maternity leave, with an average duration of about 14 weeks and, often, 100 percent wage replacement. By comparison, in OECD countries, longer leaves are frequently paid at lower replacement rates (77 percent on average).²¹ Paid paternity leave is less widespread and typically much shorter than maternity leave: in comparison, fathers' entitlements are often secondary or symbolic. Only 16 countries in the region provide paid paternity leave, and they do so for an average of seven days, with only six providing 10–15 days.

Parental leave (which can be shared between parents after maternity or paternity leave) remains rare. As of 2025, paid parental leave exists in only four countries in the region (Chile, Colombia, Ecuador, and Uruguay), and its design varies widely. In Chile and Uruguay, parental leave is available for part-time workers at a 50 percent replacement rate. In Colombia, 6 of the 18 weeks can be transferred to fathers at a 100 percent replacement rate. Ecuador offers the longest parental leave, but it is unpaid. Moreover, increasing parental leave take-up for fathers is a challenge. The fact that, in Uruguay, increasing awareness of shared parental leave only increased take-up by mothers (Querejeta et al. 2023) highlights the difficulty of changing social norms related to care. The disproportionate take-up of family leave by mothers contributes to persistent labor market penalties for women (Faundez 2019; Olivetti and Petrongolo 2017).

21. OECD Family Database. See: <http://www.oecd.org/els/family/database.htm>.

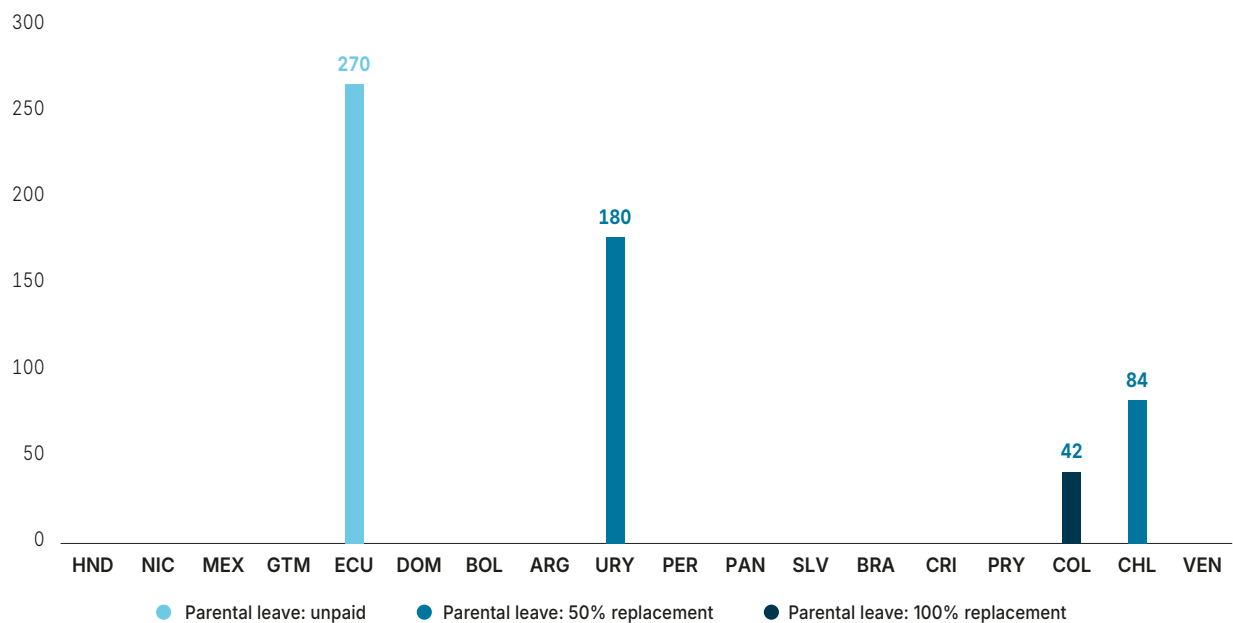
4 Making Labor Regulation Work: Incentives, Protection, and Enforcement

FIGURE 4.2 MATERNITY/PATERNITY LEAVE (DAYS), 2025



Source: Authors' elaboration, based on data from national legislation as of August 1, 2025.

FIGURE 4.3 DURATION OF PARENTAL (TRANSFERABLE) LEAVE (DAYS), 2025



Source: Authors' elaboration, based on data from national legislation as of August 1, 2025.

Other forms of family leave, such as leave to care for sick relatives or long-term dependents, are also rare (Araujo et al. 2024); in most countries, long-term care leave is restricted to childcare.²² In Latin America and the Caribbean, short-term leave for urgent family-related reasons is more common than long-term care leave, as currently 14 countries provide it. However, in all countries except for The Bahamas, this cost is borne by the employer (ECLAC and ILO 2025).

This question of who pays can be a significant factor in shaping how employers perceive paid family leave and whether employees choose to use such leave. Financing arrangements further differentiate policies among countries and can be a potential barrier to their expansion. Maternity leave is usually financed through contributory social insurance or general taxation, although a few countries still rely partially or fully on employer liability schemes. For example, Jamaica finances maternity leave directly through the employer, while Ecuador, Honduras, and Trinidad and Tobago combine employer contributions with social security funding.

Paternity leave, by contrast, is typically financed entirely by employers, with only a few exceptions (Colombia, Venezuela, and Uruguay) where benefits are partially or fully paid through social security systems. By contrast, most OECD countries finance paternity leave through social insurance funds that are supported by worker, employer, and government contributions. These institutional choices matter. Employer-financed leave can discourage the hiring or promotion of women (Vijayarasa 2025), while social insurance financing spreads the cost across workers and firms.

4.2.4 Employment Protection Legislation Over Time

The last wave of labor reform (or deregulation) was in the 1990s, when many countries tried to introduce greater flexibility into specific aspects of the labor market. The main trend was to expand the available range of contractual arrangements (e.g., introducing fixed-term contracts, expanding the use of probationary periods, and facilitating subcontracting), reduce costs through regulations making it easier to lay off workers (e.g., broadening the definition of dismissal “for just cause”), and introduce unemployment protection systems based on individual accounts. However, compared with other policy areas, the overall changes remained modest. Analyses of structural and liberalization reforms implemented in the region from the mid-1980s to the late 2000s in various policy areas—trade, finance, privatization,

22. Examples include Chile (subsidies and insurance for seriously ill children), Mexico (up to 364 days at 60 percent pay for parents of children with cancer), Ecuador (25 days for children with degenerative diseases), and Costa Rica (allowance for caregivers of terminally ill patients).

taxation, and labor—conclude that labor markets were the area in which the fewest reforms were undertaken (Lora 2012a). This relative stability of labor laws contrasts sharply with the faster pace of structural reforms in other domains, particularly in financial and trade policy (Lora 2012a).

One reason for this persistence may be that labor reforms directly affect the interests and entitlements of well-organized groups, thus making change politically difficult (Lora and Olivera 2004). In addition, labor relations in much of Latin America are heavily legislated, meaning that adjustments to employment protection measures typically occur through legislation rather than collective bargaining. Changes often follow a cycle of contestation: periods of heavy regulation are followed by pushes for greater flexibility, which, in turn, provoke political backlashes demanding stronger protections. Moreover, even though the 1990s are often characterized as a period of liberalization, many countries simultaneously enacted new employment protections for specific groups; in some cases, such as Chile, previously introduced deregulation measures from the 1980s were reversed (ECLAC 2009).

Not surprisingly, alternative measures that attempt to summarize the strictness of employment regulations show little change over time. For example, the Employment Protection Legislation Index (EPL Index), which consolidates various dimensions of labor regulation into a standardized measure, captures the overall stringency of rules governing both the dismissal of workers with regular contracts and the hiring of workers on temporary contracts. It ranges from 0 to 6, with higher values indicating stricter labor market regulations. Initially constructed for nine Latin American and Caribbean countries in collaboration with the OECD, the EPL Index²³ has remained practically stable over the past decade, reflecting the enduring rigidity of labor regulations in the region.

23. The OECD's EPL Index assesses dismissal regulations based on specific indicators, including procedural requirements, notice periods, severance pay, definitions of unfair dismissal, and enforcement mechanisms. Scores are derived from detailed criteria and weighted averages to capture variation in firm size and dismissal type. The EPL is constructed as the average of dismissal laws governing employment under regular contracts (EPR) and temporary contracts (EPT).

TABLE 4.2 STRICTNESS OF EMPLOYMENT PROTECTION INDEX—LAC-9

COUNTRY	2013	2014	2015	2016	2017	2018	2019	2023
Argentina		2.56	2.56	2.56	2.56	2.56	2.56	2.56
Brazil							1.84	1.89
Chile	2.34	2.34	2.34	2.34	2.34	2.34	2.34	2.34
Colombia		1.98	1.98	1.98	1.98	1.98	1.98	1.98
Costa Rica		0.85	0.85	0.85	0.85	0.85	0.85	0.85
Mexico	2.46	2.46	2.46	2.46	2.46	2.46	2.46	2.46
Paraguay		2.02	2.02	2.02	2.02	2.02	2.02	2.02
Peru		1.80	1.80	1.80	1.80	1.80	1.80	1.80
Uruguay		0.98	0.98	0.98	0.98	0.98	0.98	0.98
OECD		2.27	2.28	2.28	2.28	2.27	2.27	2.27

Source: OECD and the authors' estimates for 2023 based on labor legislation review.

Note: The index has values ranging from 0 to 6, where 0 represents the least strict level of protection (indicating more flexibility for employers to hire and fire workers), and 6 represents the strictest level (indicating stronger protections for employees and making it more difficult and costly for employers to dismiss workers).

Recently, Alaimo, Altamirano, and Minaya (2026) updated a subcomponent of the EPL Index that focuses specifically on the stringency of dismissals of workers with regular contracts.²⁴ Measures of this subcomponent, known as employment protection of regular contracts (EPR), indicate that, in the English-speaking Caribbean, dismissal regulations tend to be less stringent than those in Latin America. This conclusion is consistent with alternative measures of *de jure* regulations indicating that former British colonies generally maintain more flexible labor regulations than countries with French, Portuguese, or Spanish colonial legacies (Ronconi, Támara, and Fernández Díez 2022).

EPR measures are also notably stable, with only a few country-specific changes, particularly in Brazil and Belize (Appendix 7). Indeed, across Latin America and the Caribbean, post-2020 reforms have focused mainly on telework and other flexible work arrangements, while

24. This subcomponent includes notification procedures, severance pay, and the definition of an unfair dismissal, among other regulations associated with dismissal regulation, and is available for a broader set of countries. Venezuela exhibits the strictest regulation against dismissals, followed by Bolivia, Chile, Panama, and Argentina.

dismissal-related parameters have remained largely unchanged (Alaimo, Altamirano, and Minaya 2026). In fact, even in countries with reforms, dismissal-related parameters were largely unaffected. For example, Mexico's 2020 reform substantially altered the resolution of labor disputes but did not change severance formulas or probationary periods.

Thus, the regulatory landscape surrounding employment protection remained relatively stable over the past decade despite ongoing debates about its effectiveness. Indeed, its impact on productivity and equity has been widely contested, with a substantial body of literature, including previous IDB publications, highlighting the trade-offs and unintended consequences.

4.2.5 Regulations for Nontraditional Labor: The Case of Platform Workers

Technological advances have introduced new forms of work in the region, expanding employment and income opportunities. At the same time, these advances challenge existing labor laws, as traditional employment relationships often do not apply. This is the case for platform-mediated work, which is typically short-term or performed remotely and falls into two main categories: location-based work, such as transportation or home services provided in person, and online task-based work, which involves tasks carried out and delivered entirely online.

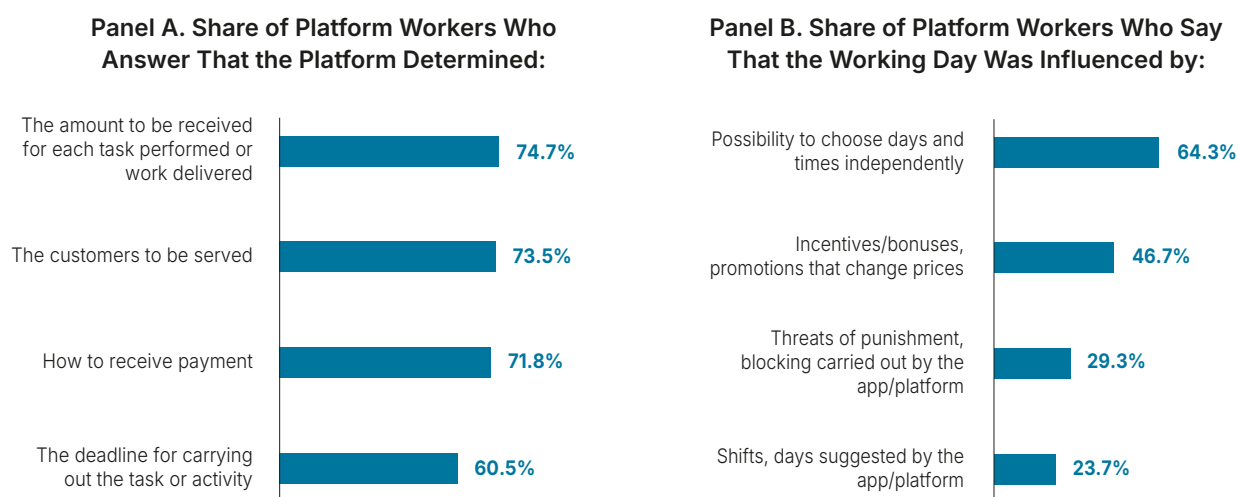
Work on digital platforms often deviates from standard employer-employee relationships, typically involving a triangular relationship among the worker, the platform, and the client. In Latin America and the Caribbean, platform work tends to be a secondary source of income, with estimates suggesting that only 25 percent of platform workers rely on it as their main occupation (Datta et al. 2023). As pointed out in Chapter 2, around 1.5 percent of total workers perform platform work as their main occupation.

For years, in the absence of specific rules or judicial decisions on the employment status of digital platform workers, platforms positioned themselves as intermediaries that merely facilitated connections, and workers were classified as self-employed. However, this classification has come under increasing scrutiny. A growing debate has emerged regarding whether some platforms exercise significant control over workers through algorithms that direct and supervise their activities. Moreover, these algorithms may be determining task allocation and, consequently, workers' earnings, with little transparency. In some cases, platforms also appear to exert disciplinary control, such as by deactivating workers' accounts—effectively terminating their work relationship (Ramírez Bustamante et al. 2021; Datta et al. 2023).

In Brazil, suggestive evidence indicates that platform workers experience more autonomy than traditional salaried employees but a higher degree of subordination than traditional independent workers.

Data from Brazil's 2022 household survey, which includes a specialized module providing indicative evidence of platform workers' autonomy and subordination, illustrate this point.²⁵ According to most of the platform workers surveyed, key aspects such as price determination, customer selection, payment methods, and deadlines are controlled by the platform. However, 64 percent of workers report having the flexibility to choose their working days and times independently (Figure 4.4). This finding suggests that platform workers experience more autonomy than traditional salaried employees but a higher degree of subordination than traditional independent workers. These characteristics present conceptual challenges for policymakers. Chapter 8 focuses on the regulatory options for this group.

FIGURE 4.4 DEGREE OF AUTONOMY AMONG BRAZIL'S PLATFORM WORKERS



Source: Authors' calculations using Brazil's 2022 household survey.

25. Pesquisa Nacional por Amostra de Domicílios Contínua [Continuous National Household Sample Survey]. Included are taxi apps such as 99taxi, cooperative, and city hall apps; private passenger transport apps such as Uber, 99, and other regional/local applications; food and product delivery apps such as iFood, Rappi, Loggi, and other regional/local applications; and general and professional service provision apps such as GetNinjas, Parafuzo, Freelancer, Workana, and 99freela.

Concerns have also been raised regarding working conditions and occupational risks. For example, cleaners may be exposed to harmful chemicals, delivery workers face driving hazards, and online task-based workers may encounter psychological risks from exposure to sensitive material. Furthermore, issues related to the violation of collective bargaining rights and freedom of association have emerged (Ramírez Bustamante et al. 2021; Datta et al. 2023).

Recent court cases, particularly in developed countries but also in Latin America and the Caribbean, have increasingly classified workers for location-based, ride-hailing, and delivery platforms as employees. These rulings have been driven by factors such as the limitation of workers' autonomy and unilateral wage determination and the platforms' control over many aspects of the service. By contrast, judgments concerning online task-based work offering services to private households or businesses have been mixed, with several rulings concluding that workers have greater autonomy and less supervision, so they can negotiate pay directly with clients. These court decisions are said to be guided by the “primacy of facts” principle, which involves attempts to consider the actual nature of the work performed and workers' compensation, regardless of contractual provisions (Ramírez Bustamante et al. 2021; Datta et al. 2023).

Regulatory approaches vary across Latin America and the Caribbean and, consequently, business models have adapted in different ways. A comparative analysis of 64 digital platforms providing domestic and care work services in Latin America by the ILO found a wide variety of business models and work arrangements. In Brazil and Mexico, domestic and care work platforms commonly operate as intermediaries of independent work contracts, while, in Chile, they tend to hire workers under formal employment relationships, offering social security benefits, minimum wage protections, and unemployment insurance (ILO 2023). Some countries are also starting to leverage the advantages of platform work for enhancing formalization. Since platforms operate through electronic payment systems, workers' incomes become more transparent, and this greater transparency provides opportunities for formalization, insurance, and pension savings.²⁶

26. For instance, recent IDB studies have highlighted significant opportunities and challenges in offering retirement savings options to workers in ride-hailing and delivery platforms across the region (Azua et al. 2022a, 2022b). In this context, WorkerTech, a new IDB Lab initiative, is providing support to platform workers by helping them obtain insurance as well as by facilitating representation.

Jurisprudence and regulatory frameworks in Latin America and the Caribbean are still evolving. As seen in Box 4.1, countries in the region have begun to regulate location-based platforms, setting interesting examples for the rest of the region. Despite differences in classification, Chile, Mexico, and Uruguay share common provisions, such as access to social security, training, and equipment and the right to unionize, regardless of employment status.

A fundamental feature of the regulation of platform work is algorithmic transparency. Algorithmic transparency is the requirement that automated decision-making systems clearly explain how they use data and enact rules that affect people. For platform workers, this form of transparency involves, for example, understanding how algorithms set pay, assign tasks, evaluate performance, and trigger suspensions and deactivations as well as ensuring that regulators also have access to this information for oversight and enforcement.

When it comes to algorithmic transparency, most countries in the region that have begun regulating location-based platforms have introduced oversight mechanisms for algorithms, such as antidiscrimination clauses (Box 4.1). Chile and Uruguay grant regulators the authority to access the technical details of algorithms and authorize workers to access their “digital reputation” data, such as evaluations and rating histories. Mexico does not provide for either. However, Mexico and Uruguay require platforms to disclose and explain how algorithms influence key work decisions to workers directly rather than only to authorities. Chile ensures access to certain evaluation data but does not mandate full transparency of algorithmic logic to workers. Among the three countries, Uruguay has the most extensive policies on algorithmic transparency, granting both workers and regulators the access necessary to understand and monitor algorithmic decisions, an approach that aligns more with EU-style regulations, as outlined below.

BOX 4.1 RECENT APPROACHES TO THE REGULATION OF PLATFORM WORK IN LATIN AMERICA AND THE CARIBBEAN

Platform workers are usually concentrated in a few dominant platforms and can have limited autonomy, so there are significant market power risks (OECD 2019; Dube et al. 2020). Unlike dependent workers, independent workers cannot access the basic tools that are used to combat these risks, such as collective bargaining or minimum wages. However, new regulations in Chile, Uruguay, and Mexico are examples of how countries in the region are responding to address this gap.

Country	Applicability	Classification	Algorithmic Transparency	Other Labor Protections
Uruguay (Law 20.396, 2025)	Location-based: platform workers in the transportation sector (delivery and ride-hailing).	Flexible: classification depending on working conditions.	All workers: 1. Disclosure of how algorithms assign tasks, evaluate, suspend, or affect pay. 2. Workers' data are protected, and they have access to their data in a portable format. 3. Antidiscrimination clauses in algorithms. 4. Authorities can access technical details of algorithms to ensure compliance.	All workers: 1. Right to unionize. 2. Right to training and equipment. Dependent: 1. Minimum wage. 2. Maximum hours. 3. Full access to social security. Independent: Workers can voluntarily register in single tax regime (<i>monotributo</i>).
Chile (Law 21.431, 2022)	Location-based: platform workers who provide physical and local services in Chilean territory through digital intermediation platforms.		All workers: 1. Workers' data are protected, and they have access to their data in a portable format. 2. Antidiscrimination clauses in algorithms. 3. Authorities may request access to an algorithm's code, training data, and decision logic.	All workers: 1. Right to unionize. 2. Right to training, equipment, and property insurance. 3. Required to have a labor contract. 4. Minimum wage (prorated). Dependent: 1. Maximum working hours. 2. Enrollment in social security. Independent: 1. Minimum disconnecting hours. 2. Dismissal notification rules. 3. Must self-enroll in social security.
Mexico (DOF Decree, December 2024)	Location-based: platform workers in the transportation sector (delivery and ride-hailing).		All workers: 1. Clear description of how algorithms assign tasks and determine payments to workers. 2. Notification when automated decisions affect workers' income or access to work. 3. Nondiscriminatory algorithmic treatment and mechanisms for human review.	All workers: 1. Right to unionize. 2. Right to training and equipment. 3. Required to have a labor contract. 4. Proportional compensation for rest, vacation, and holiday bonus. 5. Work injury insurance. Dependent: 1. Enrollment in social security. 2. Right to profit-sharing.

Source: Uruguay (Law 20.396, 2025); Chile (Law 21.431, 2022); Mexico (DOF Decree, December 2024).

Note: In June 2025, Colombia also passed a labor reform regulating platform work based on the presumption of employment. The Colombian law also extends access to social security and algorithmic transparency to all platform workers; however, it does not explicitly grant the right to unionize and thus creates a gap in collective labor rights protections for workers operating in independent arrangements.

Regulatory challenges arise not only from the diverse nature of these new forms of work but also from the global scope of task-based online work. While countries are beginning to regulate workers in location-based platforms, workers who perform online-based tasks can cross national jurisdictions, so the design and enforcement of labor regulations are particularly difficult. The persistence of this regulatory gap in most countries raises complex questions regarding the applicability of labor standards, taxation, and social protection obligations across borders. Moreover, the ability of multinational platforms to exploit differences in local regulations may complicate oversight and compliance.

4.3 Minimum Wages: Promise, Risks, and Trade-Offs

Minimum wage laws date back to the late nineteenth century, first introduced in New Zealand and Australia, and soon after adopted in the United Kingdom and the United States. In Australia, New Zealand, and the United States, the aim of minimum wages was to guarantee workers a basic level of compensation that would secure a minimum standard of welfare. In the United Kingdom, however, the objective was narrower: rather than establishing a living wage, the policy sought to combat the payment of extremely low wages in specific trades, that is, "sweatshops" (e.g., wholesale tailoring), which primarily employed women and young workers. In this way, the minimum wage was conceived as a tool to address severe imbalances in bargaining power in certain sectors (Del Carpio and Pabón Alvarado 2015; Dube and Lindner 2024).

Latin American countries were among the early adopters of minimum wage policies. In Brazil, Chile, and Mexico, minimum wages were introduced as early as the 1930s, while in Argentina, Costa Rica, Colombia, and the Dominican Republic, minimum wage systems were established in the 1940s. Historical accounts suggest that this was, in part, an effort by Latin American and Caribbean governments to shift workers' reliance on labor unions to the state for the protection of their interests. In contrast, in European countries with strong union representation, such as Austria, Italy, and Sweden, the adoption of minimum wage legislation was delayed, as unions feared that state involvement in labor relations could diminish their influence (Dube and Lindner 2024).

English-speaking Caribbean countries adopted minimum wage legislation more recently, after gaining independence. For example, Jamaica introduced a national minimum wage in 1975 as part of a poverty-alleviation strategy aimed at protecting the earnings of workers in nonunionized sectors. Trinidad and Tobago followed much later, implementing a minimum wage policy in 1998 (Heckman and Pagés 2004). Currently, nearly all countries

in the region have enacted minimum wage legislation. In many cases, it is even embedded in their constitutions; thus, by 2015, 17 of 18 Latin American constitutions contained specific provisions regarding the minimum wage (Alaimo et al. 2015).

Today, minimum wages typically seek to establish an income floor that serves two distinct but related objectives. First, following ILO standards,²⁷ this floor can protect workers by guaranteeing a minimum level of income that supports what is considered a decent standard of living. Second, in monopsonistic labor markets, it can serve as a tool to ensure that wages accurately reflect workers' productivity and contribution, thereby making compensation equitable. In this way, an income floor can address distortions in labor markets in which wages do not naturally reflect productivity, as discussed below.

4.3.1 The Economics Behind the Minimum Wage Debate

Economic theory predicts ambiguous effects of minimum wages on the wages and welfare of low-income workers. These predictions vary depending on the degree of labor market competition.

In a perfectly competitive labor market, in which many firms compete for workers, and no single employer can influence wage levels, setting a minimum wage above the market-clearing level reduces employment in the covered, formal sector. Those who remain employed, however, benefit from higher wages. Therefore, the net welfare effect in the formal sector depends on whether the wage gains for employed workers outweigh the losses from reduced employment. The impact on the uncovered, informal sector is also unclear. If displaced formal workers enter the informal market, the resulting increase in labor supply could lower both employment opportunities and wage levels. There are also important distributional impacts. High minimum wages may also induce automation, potentially harming low-skilled workers in the long run (Hurst et al. 2022).

Predictions differ in noncompetitive labor markets, in which firms hold monopsonistic power and can influence wages and working conditions. Such situations occur, for example, in markets with few employers or when workers face high search costs that limit job mobility and leave them with few alternatives. In these contexts, workers have limited bargaining power and may accept wages below the value of what they produce. Here, introducing a minimum wage can raise the earnings of low-wage workers without reducing employment and may

²⁷. ILO Minimum Wage Fixing Convention and Recommendation, 1970 (Nos. 131 and 135).

even increase overall formal employment (Card and Krueger 1995; Dube and Lindner 2024). However, this effect depends on the size of the increase: even in monopsonistic markets, excessively high minimum wages lead to job losses in the formal sector.

Thus, when monopsony power is present and the minimum wage is initially low, there is a clear economic rationale for raising it on both equity and efficiency grounds. Nonetheless, claims that minimum wages can be increased without careful analysis are misleading: if workers generate US\$100 in additional revenue, but the minimum wage is set at US\$200, a firm will not hire them, regardless of market power.

Lastly, minimum wages can appear fiscally attractive compared with other policy measures. In monopsonistic labor markets, suppressed wages can shift part of the cost to the government through income support and social protection, thereby increasing the fiscal burden of compensatory transfers (Lehner et al. 2024). In this sense, minimum wages may be preferable. However, although minimum wages may seem costless, when they increase informality or create distortions, as discussed below, they can generate fiscal losses through reduced tax revenue and lower social security contributions.

4.3.2 Who Sets the Minimum Wage and How?

Mechanisms for setting minimum wages generally fall into two categories: statutory systems and those established through collective bargaining. Most countries (93 percent) have statutory minimum wages. In Latin America and the Caribbean, statutory minimum wages are also the norm, the exceptions being Argentina, Brazil, and Uruguay, where collective bargaining mechanisms play a significant role, granting greater influence to other social actors (ILO 2021a; Gindling and Ronconi 2025).

In practice, the most common mechanism for setting statutory minimum wages in the region is through a tripartite wage council. These councils, composed of representatives from workers, employers, and the government, discuss and propose a wage, which is then submitted to the executive authority—typically the Ministry of Labor—for final approval. However, variations in this process exist. In Jamaica and El Salvador, the wage council serves only an advisory role, with the Ministry of Labor having sole responsibility for setting the minimum wage. In Colombia and Panama, when the tripartite council fails to reach an agreement—which happens frequently—the Ministry of Labor sets the wage by decree. Meanwhile, in Costa Rica, Paraguay, and Peru, the minister has the authority to either accept or reject the majority proposal of the council (Messina and Silva 2018).

Unlike other countries in the region, Argentina, Brazil, and Uruguay grant other social actors a leading role in establishing minimum wages, with less direct government intervention. In Argentina, minimum wages are determined by a bipartite commission of employers and workers, without government involvement. In Brazil, minimum wages are approved by Congress. In Uruguay, the national minimum wage is set by the executive branch (central government) and periodically adjusted, typically by decree, to reflect economic conditions such as inflation and cost-of-living changes. Additionally, in all three countries, specific economic sectors can establish minimum wage floors through collective bargaining between employers and workers (Messina and Silva 2018; Gindling and Ronconi 2025). Box 4.2 describes the process in Uruguay in greater detail.

BOX 4.2 MINIMUM WAGE SETTING THROUGH COLLECTIVE BARGAINING IN URUGUAY

Between 2005 and 2019, Uruguay implemented significant and sustained real minimum wage increases, thereby achieving large wage gains for low-wage earners, with minimal negative effects on aggregate employment (González-Pampillón and Vázquez-Grenno 2025). The institutional design behind this increase placed collective bargaining agreements at the forefront of minimum wage policy. In 2005, Uruguay reinstated a 1943 wage-setting system that combined a national minimum wage set by decree and sector-specific minimum wages negotiated through tripartite wage councils. At first, the negotiated sector-specific minimum wages applied to the signatory parties of the agreement. However, in 2009, Uruguay modified this law so that the collective agreements became legally binding on all employers and workers in the sector. After wage councils were reinstated, the share of workers protected by collective bargaining increased from 28 percent in 2000 to 96 percent in 2006 (Mazzuchi 2009). Although there was still a national minimum wage established by decree, in practice, most workers' minimum wages were dictated by collective agreements.

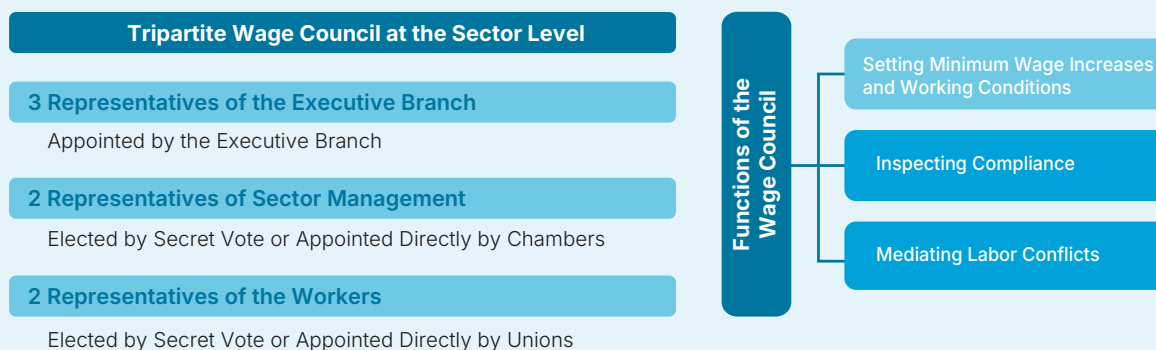
Institutional Design

Sectoral collective bargaining can take place in two ways: through the tripartite wage councils or bipartite collective bargaining. However, most sectors operate under the wage council model, a three-party model of collective bargaining by industrial sector.

TWO OPTIONS FOR MINIMUM WAGE NEGOTIATIONS	
Tripartite Wage Councils (most sectors)	Collective Bargaining
Wage increases are negotiated in cycles (every two to three years) and are mostly based on specifically defined criteria. When unanimity is not reached, wage adjustments are determined by a majority vote of the council members. When a vote cannot be held, or no majority is achieved, the executive branch has the authority to set the respective wage adjustments. The national minimum wage is set by presidential decree following informal consultation with stakeholders and as part of broader collective discussions in the wage councils. Law 20.145 (enacted in 2023) introduced the provision that, once a contract expires, its terms cease unless a new agreement has been signed.	In the case of bipartite collective bargaining, the employers (represented by their respective business chambers) and workers (represented by the sectoral union) negotiate a collective agreement bilaterally. Once signed, the agreement is registered with the Ministerio de Trabajo y Seguridad Social [Ministry of Labor and Social Security]. Law 20.145 (passed in May 2023) fortified collective bargaining for unrepresented workplaces: when no workplace-level union exists, workers (rather than the sectoral union) can organize and directly negotiate a collective agreement.

Figure 4.5 illustrates the members and functions of the tripartite wage councils. Their main role is deciding on the minimum wage increases and working conditions for each industrial category, but Law 18.566 (2009) extended their scope to include acting as an inspection body to monitor compliance with minimum wage regulations and mediate in labor conflicts.

FIGURE 4.5 MEMBERS AND FUNCTIONS OF THE TRIPARTITE WAGE COUNCIL



Source: Authors' elaboration based on the Collective Bargaining Act (Law 18.566, September 2009).

The Role of the Executive

The executive branch plays a dominant role in wage negotiations. The criterion used to evaluate wage increases is mainly past and future inflation, with occasional use of productivity considerations. However, adjustments can be made following *pautas* [government guidelines], which influence negotiations and act as a balancing point between two parties with opposing interests. For example, in the eighth round of negotiations during the economic crisis in 2020, the guidelines focused on containing costs with no real wage increases. Most sectors received only a 3 percent nominal adjustment, while inflation was around 9 percent, implying a real wage loss of about 6 percent. In the tenth round of negotiations (2023), the guidelines targeted full recovery of the real wage in stages. Sectors with real wage loss negotiated recovery adjustments in three phases, and sectors without real wage loss adjusted with projected inflation (Instituto Cuesta Duarte 2024).

Complementary Policies to Strengthen Collective Bargaining

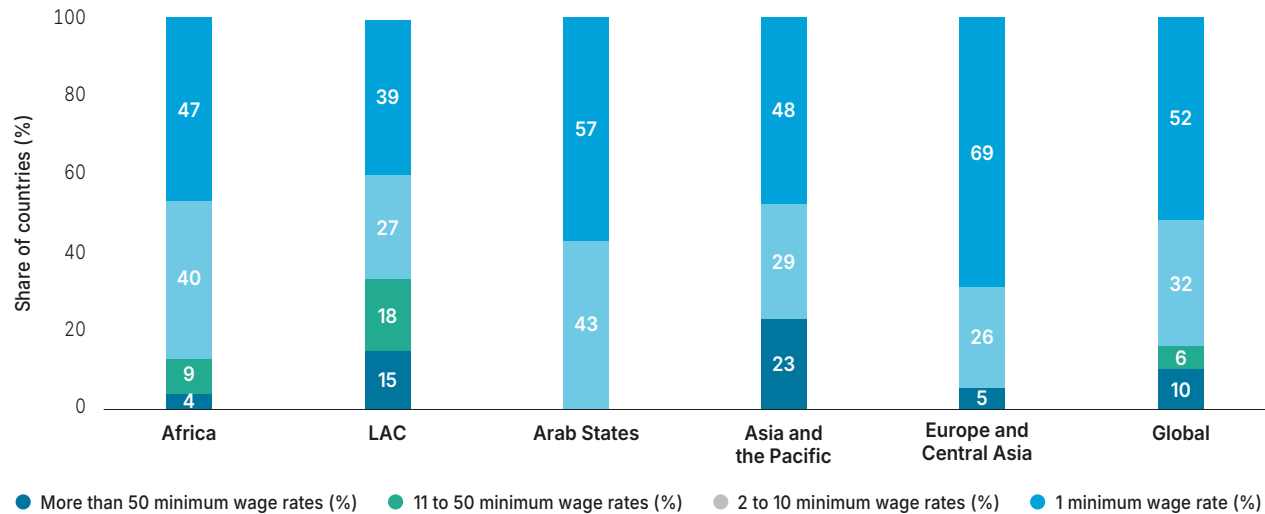
Uruguay's wage-setting system relies on self-regulation, but it requires a union rights promotion policy to achieve effective bargaining on behalf of workers. To this end, the government prioritized strengthening collective bargaining and compliance through two main policies:

- **Protecting Union Activities:** Law 17.940 (2006) complemented the foundational Trade Union Act by protecting unionized workers against discriminatory action, including providing safeguards against antiunion behavior (such as immediate reinstatement) and paid leave to carry out union-related duties.
- **Strengthening the Labor Inspection Bureau** by increasing resources, hiring inspectors under exclusivity contracts, and increasing wages.

An important consideration is whether countries implement a single minimum wage or allow for variations. While approximately one-third of countries in Latin America and the Caribbean establish a single national minimum wage (e.g., Bolivia, Colombia, and Peru), most apply various rates based on sectors, occupations, age groups, or regions. Countries such as Honduras set minimum wages by industry, whereas Costa Rica sets differential minimum wages based on education and skill level. In Chile, the minimum wage varies by age group, with differential rates for those under 18 and over 65. Several countries also set differential minimum wages by jurisdiction. Mexico used to have a very complex system with almost 120 distinct levels of regional minimum wages but gradually unified them into a national rate through a process that ended in 2015. Currently, the country has a higher rate only in the northern border area (Zona Libre de la Frontera Norte [Northern Border Free Zone]). Nonetheless, it still has 61 distinct minimum wages set by profession and trade. Brazil has permitted states to set higher minimum wage floors since 2000 (Del Carpio and Pabón Alvarado 2015; ILO 2020; Gindling and Ronconi 2025).

Some countries have highly complex minimum wage systems. For example, in Panama, where minimum wages vary by region, occupation, economic sector, and firm size, there are more than 50 minimum wage rates. In a worldwide comparison of countries with statutory minimum wages, Latin America and the Caribbean is notable for its relatively high prevalence of multiple minimum wage rates (Figure 4.6).

FIGURE 4.6 DISTRIBUTION OF COUNTRIES BY NUMBER OF MINIMUM WAGE RATES²⁸



Source: ILO (2020).

4.3.3 A Floor for All? Levels, Compliance, and Incidence in the Informal Labor Market

In absolute terms, the average monthly minimum wage in Latin American and Caribbean countries in 2023 was approximately US\$771 at purchasing power parity (PPP), exceeded only by Sub-Saharan Africa and South Asia, and only 4 percent below the global average (population-weighted). Table 4.3 shows the values across countries, with the third column specifying the selected rate in countries with multiple minimum wage levels. There are significant disparities, with the lowest rates found in Haiti's manufacturing sector and the highest in Bolivia. Notably, within-country variation can be quite large in countries with multiple wage levels. For instance, the minimum wage for lawyers in Rio de Janeiro can be nearly US\$600 higher than Brazil's federal minimum wage (ILO 2020).

Noncompliance is widespread: 37 percent of salaried workers—at least 62 million people—earn below the minimum wage, more than twice the global average.

²⁸. Based on ILO (2020). The data exclude non-ILO member states and countries with nonstatutory minimum wage rates.

TABLE 4.3 STATUTORY MONTHLY MINIMUM WAGE, 2023

COUNTRY	US\$ PPP (2021)	TYPE OF MINIMUM WAGE
Haiti	270.7	Sectoral (manufacturing)
Mexico	421.0	National floor
Suriname	465.2	National floor
Brazil	522.9	National floor
Peru	532.8	Single national
Barbados	552.2	Single national
Belize	585.7	Single national
Jamaica	594.1	National floor
Guyana	615.5	Single national
Uruguay	684.5	Single national
Dominican Republic	697.7	Average based on establishment size*
Colombia	726.3	Single national
El Salvador	744.0	Sectoral (manufacturing)
Bahamas	793.7	Single national
Paraguay	813.7	National floor for adults
Argentina	833.6	Single national
Honduras	834.7	Sectoral (manufacturing—small firms)
Chile	835.1	National floor for adults
Panama	861.3	Sectoral (manufacturing—small firms)
Costa Rica	891.6	Occupational (general unskilled)
Guatemala	904.4	Sectoral (manufacturing)
Ecuador	914.1	National floor
Trinidad and Tobago	914.5	Single national
Bolivia	1,039.6	Single national

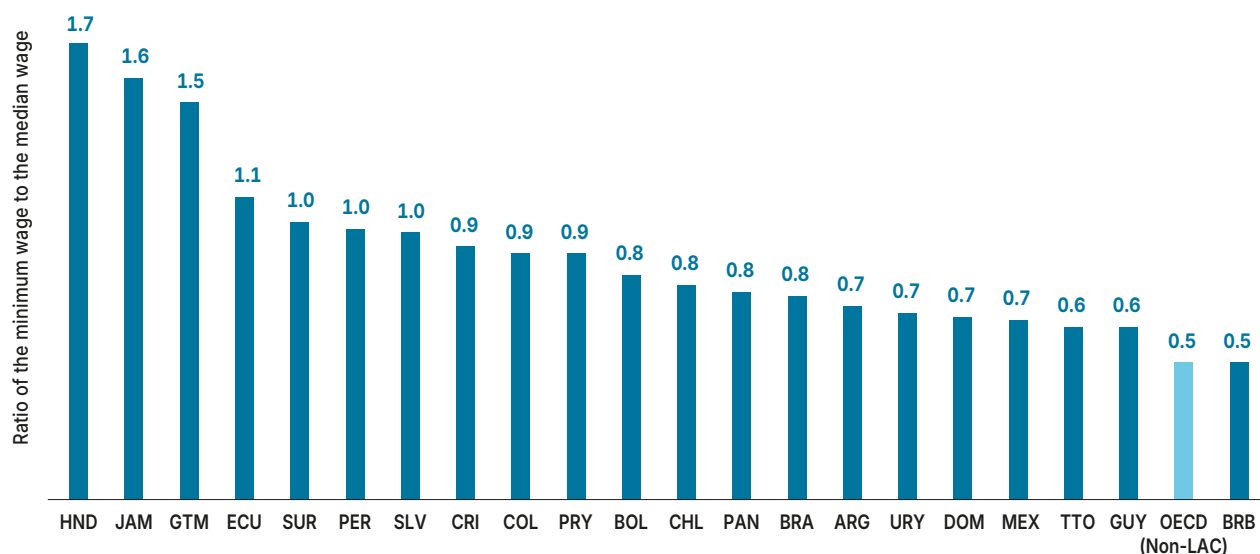
Source: ILO.

Note: Argentina's minimum wage is taken from Resolution No. 15/2023. * = nonsectorized private sector.

4 Making Labor Regulation Work: Incentives, Protection, and Enforcement

More important than the absolute value is the relative importance of the minimum wage in the local labor market. A common way to measure the relative importance is by computing the ratio of the minimum wage to the median labor income of the occupied population. This ratio, also known as a variation of the Kaitz index, is one of the most widely accepted measures of the impact of the wage floor. The comparison of these ratios presented in Figure 4.7 shows large cross-country disparities. In countries in which minimum wages vary by firm size or by sector, the distribution of workers earning below the lowest nonagricultural minimum wage is compared. Honduras, Jamaica, and Guatemala have the highest ratios, 170, 160, and 150 percent, respectively. By contrast, Caribbean countries have the lowest ratios in the region, typically falling between 40 and 60 percent. However, most countries in Latin America and the Caribbean have a higher ratio of minimum wage to median wage compared with the OECD, at 52 percent.

FIGURE 4.7 MINIMUM WAGE AS A SHARE OF MEDIAN LABOR INCOME IN THE MAIN OCCUPATION, CIRCA 2023



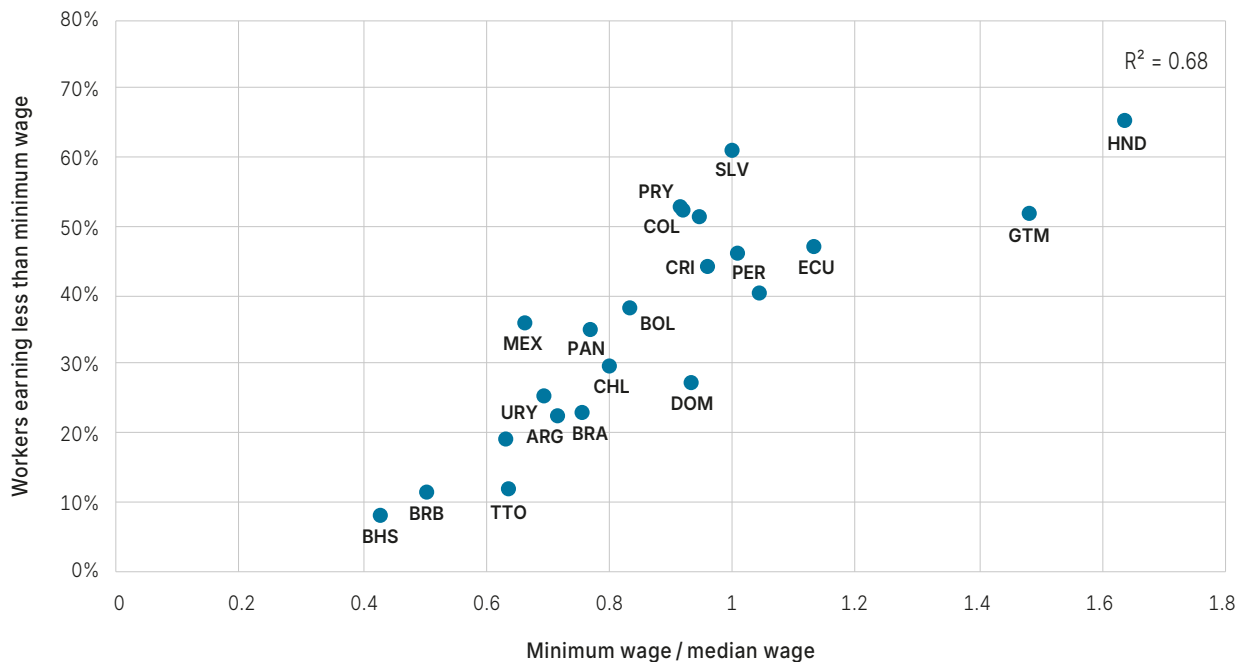
Source: Authors' calculations using the latest available data from the ILO and IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: In countries with more than one minimum wage, the lowest nonagricultural minimum wage was used. The data for Trinidad and Tobago, and Barbados are from 2015 and 2016, respectively.

A significant share of salaried workers in Latin America and the Caribbean earn below the minimum wage. Thus, in 2023, 37 percent of salaried workers—amounting to at least 62 million people—across 16 Latin American and Caribbean countries with available data earned less than the minimum wage, well above the global average of 15 percent reported by the ILO in 2020 (ILO 2020). This large share of salaried workers earning less than the minimum does not reflect legal exclusions. Although certain groups (e.g., domestic workers in Peru, El Salvador, Honduras, and the Dominican Republic; and agricultural workers in Bolivia) are exempt from minimum wage laws, they make up only a small portion of the salaried workforce. Instead, the main issue is noncompliance with minimum wage legislation, which is intended to serve as a wage floor for most salaried workers. Noncompliance rates are high on average, although they also vary widely by country, reaching more than 55 percent in Honduras and Guatemala, while Brazil, Chile, and Argentina have the lowest rates, of less than 20 percent. Clearly, simply setting a minimum value in the law does not always translate into higher wages for salaried workers.

The share of workers who earn less than the minimum wage is high in countries where the minimum wage is high compared with the wage distribution. Thus, in Central American countries with high minimum-to-median wage ratios, such as Honduras, Guatemala, and El Salvador, more than 50 percent of workers have monthly earnings below the minimum wage (Figure 4.8). By contrast, Caribbean countries such as Barbados and The Bahamas have low minimum wage ratios and low levels of workers earning less than the minimum. This positive relationship, depicted in Figure 4.8, does not, by itself, of course, imply causation. The causal impacts of the minimum wage are discussed later in the chapter. However, this relationship highlights a key challenge in countries such as Honduras and Guatemala, where minimum wages are set at high levels relative to the productivity of labor. In such cases, the minimum wage becomes more of an aspiration and is effectively not applicable to most workers, and it may encourage excessive informality or self-employment, contexts in which, of course, minimum wages do not exist.

FIGURE 4.8 SHARE OF TOTAL WORKERS EARNING LESS THAN THE MINIMUM WAGE, CIRCA 2023

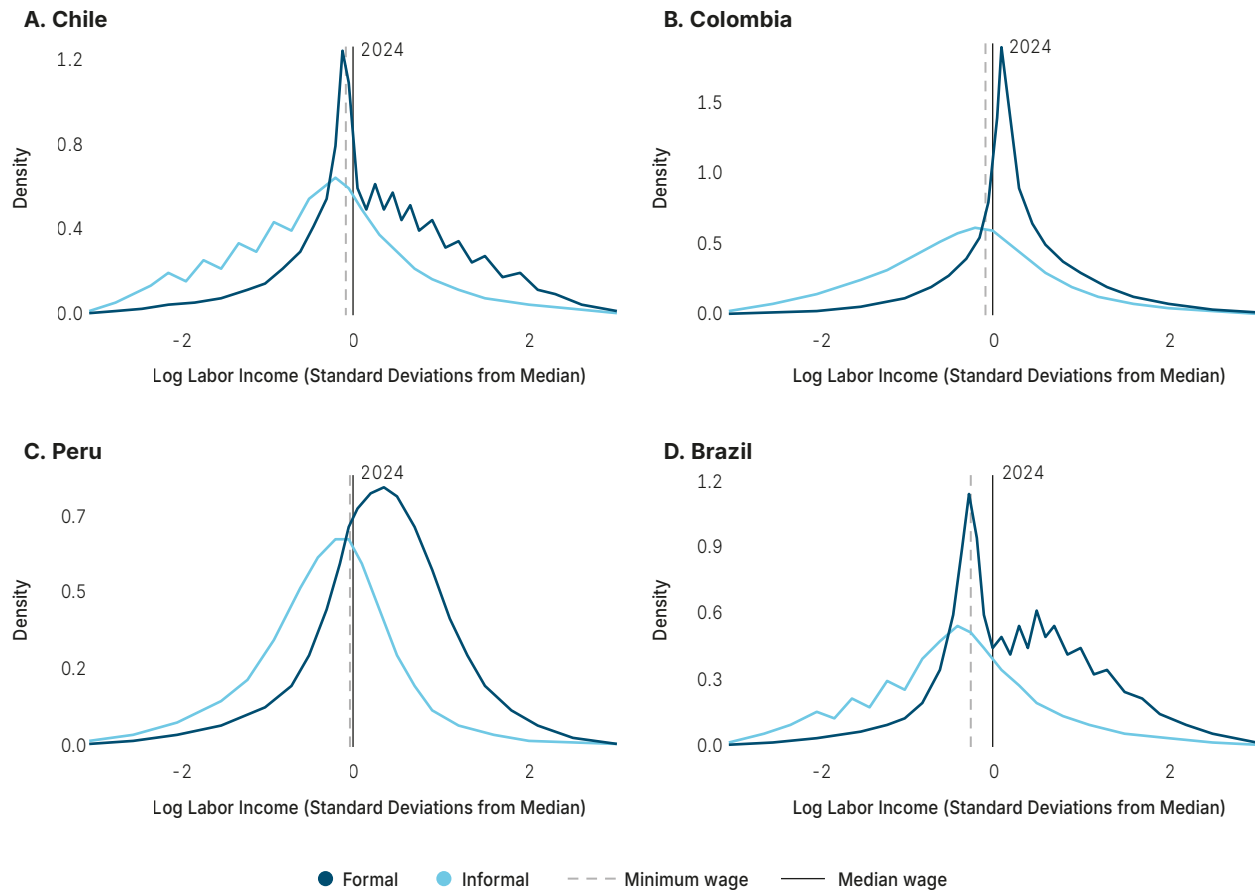


Source: Authors' elaboration based on data from the ILO (minimum wage) and IDB (2025), IDB Harmonized Survey System.

Note: Earnings refer to hourly labor income in the main occupation of all workers aged 15–64 years. In countries with more than one minimum wage, the lowest nonagricultural minimum wage was used. The data for Trinidad and Tobago, The Bahamas, and Barbados are from 2015, 2013, and 2016, respectively.

Even though minimum wages, by definition, govern salaried labor in formal markets, in many countries, minimum wages affect the wages of informal workers. This phenomenon, known in the specialized literature as the “lighthouse effect,” has been extensively documented in Latin American countries (Maloney and Núñez Méndez 2003; Boeri, Garibaldi, and Ribeiro 2010; Bosch and Manacorda 2010; Derenoncourt et al. 2025). Figure 4.9 illustrates this point with the distribution of the labor income of formal and informal workers for four countries in Latin America and the Caribbean with a single minimum wage for adults, namely, Chile, Colombia, Peru, and Brazil. In every country, there is bunching around the minimum wage in both the formal and the informal sectors. This phenomenon indicates that, even though not enforced by law, minimum wages may affect the reservation wage of all workers in an economy and may be viewed as a benchmark of fair remuneration because they reach workers beyond the reach of labor law.

FIGURE 4.9 DISTRIBUTION OF LABOR INCOME AND MINIMUM WAGE LEVELS IN 2024



Source: Authors' calculations using data from the ILO (minimum wage) and IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, for wage distribution.

Note: Distributions are calculated using the labor income in the main occupation of all workers aged 15–64 years; "Formal" refers to workers with social security.

4.3.4 Minimum Wage Adjustments and Trends

As discussed, over the past two decades, most Latin American countries have experienced significant increases in the real value of the minimum wage. Some countries saw especially high increases, such as Bolivia and Honduras, in which the minimum wage increased by 153 and 123 percent, respectively. Uruguay also saw a very large increase, of 273 percent, although its initial minimum wage level was low relative to the median salaries in the rest of the region (40 percent of the median salary). Only Paraguay and Guatemala experienced a decline in real terms over the past two decades, of 17 percent and 6 percent, respectively.

In some cases, these trends reflect significant reforms of minimum wage structures. For instance, Honduras in 2009 implemented a major reform to equalize minimum wage floors across industries, regions, and firm sizes, resulting in a substantial average increase in real terms.²⁹ More commonly, however, the region has experienced sustained growth in minimum wages through periodic adjustments, typically on an annual basis. In fact, most countries in Latin America and the Caribbean adjust their minimum wages yearly, the exceptions being Suriname, Barbados, and Belize, where adjustments have occurred every three years or less frequently,³⁰ and Panama and Honduras, which enacted multiyear agreements in 2024.³¹

Typically, adjustments are based on a variety of indicators related to inflation and productivity growth. Some countries, such as Brazil and Costa Rica, define a formula for determining adjustments based on variables such as gross domestic product (GDP) growth and inflation that can be revised periodically (ILO 2016). Additionally, countries may implement provisions for exceptional circumstances. For example, in Costa Rica, the adjustment formula does not apply during periods of high inflation or economic downturns in key sectors such as agriculture, commerce, and construction (Banco Central de Costa Rica 2025).

The growth of real minimum wages in Latin America and the Caribbean over the past two decades has often diverged, both positively and negatively, from increases in labor productivity, as measured by GDP per worker. In countries such as Uruguay and Honduras, minimum wages have risen faster than productivity per worker, while in others, such as Panama and Peru, which experienced strong productivity growth (128 percent and 86 percent, respectively), minimum wage increases have been more modest (Figure 4.10).

However, these differences in growth rates between minimum wages and productivity should not necessarily be seen as policy mistakes. When the minimum wage is initially set too high, allowing it to grow more slowly than productivity may be the best course of action. Conversely, when the minimum wage is too low to effectively raise wages for some workers, a faster increase than product per worker growth may be the appropriate policy response. This was the case in Uruguay and Mexico, where the initial minimum wage levels were very low relative to the median salary in the rest of the region. Chapter 8 explores this issue in greater detail.

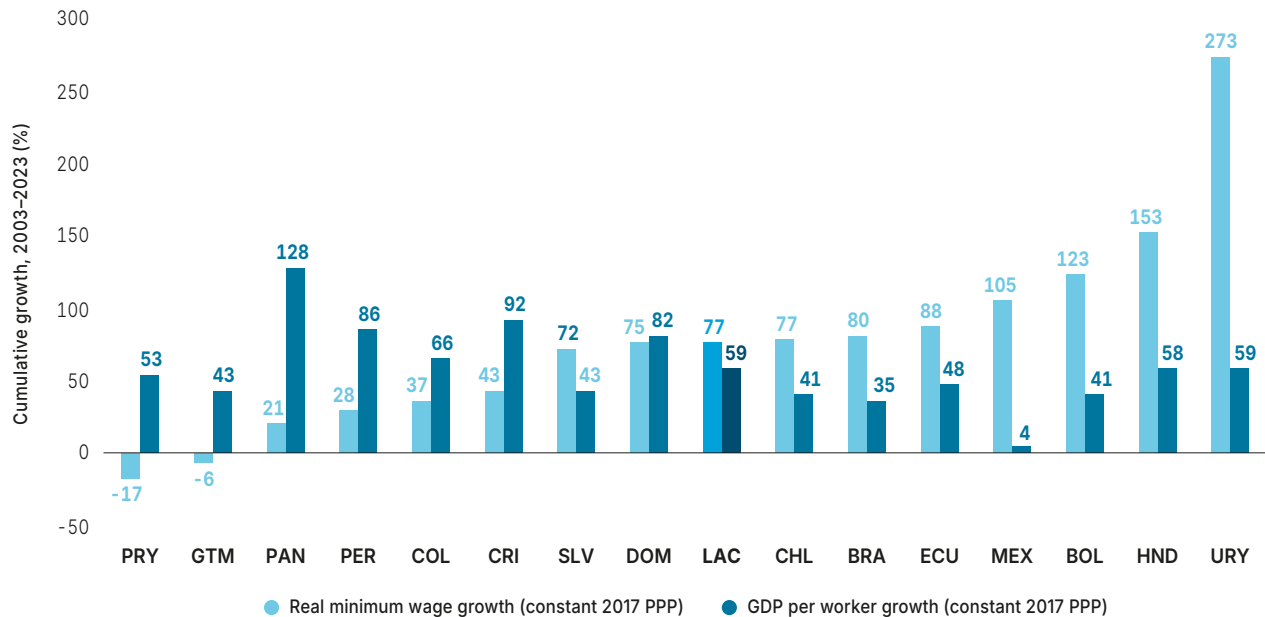
²⁹. In 2009, the minimum wage structure changed from industry-by-firm-size minimum wages (23 categories) to regional floors (2 categories), but, in 2010, it returned permanently to a modified version of industry-by-firm-size minimum wages.

³⁰. Authors' calculations using the ILO minimum wage database.

³¹. Panama: Executive Decree No. 1 of January 10, 2024. Honduras: Executive Agreement No. SETRASS-109-2024.

4 Making Labor Regulation Work: Incentives, Protection, and Enforcement

FIGURE 4.10 CUMULATIVE REAL MINIMUM WAGE AND GDP PER WORKER GROWTH, 2003–2023



Source: Authors' calculations based on ILO minimum wage data and World Development Indicators (WDI) data on GDP per worker.

Note: (1) In cases in which countries have multiple minimum wages, a representative wage was used (usually the minimum wage applicable to the manufacturing sector). (2) Uruguay's minimum wage started from a very low level in 2003, less than 40% of the median salary. In 2023, it reached about 70% of the median salary. (3) Not included in this graph is Argentina, whose real minimum wage grew by more than 450%, while its GDP per worker growth reached 57%, following the country's recovery from the 1998–2002 economic crisis, during which its GDP contracted by 28%. However, the ratio of the minimum to median salary remained around 72%.

4.3.5 One Policy, Too Many Objectives

Initially, minimum wage policies were designed with the redistributive goal of providing some balance to the otherwise asymmetric relationship between employers and workers. However, globally—including in Latin American and Caribbean countries—minimum wages have evolved into a reference measure of a standard of living for policy design. A first notable example is the value of social benefits of large social programs, which is frequently tied to the level of the minimum wage (e.g., *Asignación Universal por Hijo* [Universal Child Allowance] in Argentina and *Bolsa Família* [Family Allowance] and *Programa Nacional de Inclusão de Jovens* [National Youth Inclusion Program] in Brazil) (Abramo, Cecchini, and Morales 2019). The benefit levels of contributory pension programs are also frequently tied to the minimum wage, as is the case in Brazil and Colombia and, until recently, was the case in Mexico.

Minimum wages also serve as a benchmark for eligibility for social programs in many countries across the region. For example, among 18 countries where social security contributions are mandatory for salaried workers, 11 impose this requirement only on those earning at least the minimum wage.³² Furthermore, minimum wages are often understood as a proxy for payment capacity and are often used as a numeraire to determine the value of penalties. For instance, before a recent reform aimed at restricting the use of the minimum wage for such penalties, in Colombia, there were more than 200 distinct applications of the minimum wage to assess the value of fines, subsidies, and penalties across a wide array of sectors, including culture, public utilities, national security, and sports.³³

In Colombia, the minimum wage had more than 200 distinct applications—setting the value of fines, subsidies, and penalties across sectors from culture to sports.

Starting in 2004, Uruguay took major steps to limit the role of the minimum wage as a numeraire for social programs. Years later, Mexico implemented a similar approach. Its recent period of significant minimum wage increases, which began around 2016, was undertaken only after a substantial delinking of penalties and policies from the minimum wage.

As discussed in Chapter 7, extensive reliance on the minimum wage for multiple policy objectives complicates negotiation processes by introducing considerations beyond labor relations, rather than allowing policymakers to focus on the primary goal of improving wages, particularly for low-wage workers. A more appropriate approach would be to limit the minimum wage to its original function of setting minimum remuneration for salaried employees. This separation would avoid linking minimum wage adjustments to fiscal considerations such as the cost of social transfers or the level of fines. In this way, wage increases would not be rejected because of fiscal constraints unrelated to labor market outcomes, nor would minimum wage increases that distort labor markets be used as a substitute mechanism for expanding social transfers.

³². These are Ecuador, El Salvador, Guatemala, Honduras, Paraguay, Peru, and Venezuela. The information is sourced from national laws and regulations governing social security in each country.

³³. Decrees 2641, 2642, 2643 of 2002, and Resolution 3268 of 2023, Government of Colombia.

4.3.6 No Simple Answers: The Impacts of Minimum Wages on Labor Market Outcomes

Minimum wage increases trigger various margins of adjustment in the labor market and even beyond. Firms can respond to minimum wage increases by adjusting employment, informality, hours, firm size, technology choice, turnover, and occupational composition. Fortunately, the manner in which workers and firms respond to minimum wage increases in the formal sector is one of the most-investigated topics in empirical economics.

When the minimum wage is set too high relative to labor productivity, the results may include higher unemployment, increased informality, or shifts toward self-employment.

This literature is extensive, with findings that vary across studies, countries, and over time. However, the evidence is clear on one point: when the minimum wage is set too high relative to labor productivity, the results may include higher unemployment, increased informality, or shifts toward self-employment. For instance, a recent review of empirical studies from developing countries concludes that negative employment effects tend to arise, particularly for low-wage workers, when the minimum wage is high relative to the overall wage distribution (Neumark and Munguía Corella 2021). Theoretical models are consistent with this finding: even in monopsonistic markets, very high minimum wages can lead to job losses or increased informality. As a result, much of the economic debate focuses on the effects of minimum wage adjustments starting from low or moderate levels.

Brazil and Mexico provide evidence that minimum wage increases can have a limited impact on aggregate employment levels while having beneficial results on wages and inequality. A near doubling of the real value of the minimum wage on the northern border of Mexico significantly improved wages without any detectable effects on formal employment or a significant decrease in poverty levels (Campos-Vázquez and Esquivel 2020). In Brazil, increases in the minimum wage had far-reaching effects on wages higher up in the wage distribution (Engbom and Moser 2022) and among informal employees (Derenoncourt et al. 2025), as well as reduced inequality in both formal and informal sectors (Derenoncourt et al. 2021).

The generally positive experiences in Brazil and Mexico with increases in the minimum wage need to be analyzed in the proper context. Despite important increases, these studies were undertaken when Brazil and Mexico still had low minimum wage floors compared with their

GDP per worker and relative to the average wage. Uruguay also had a successful experience combining a national minimum wage floor with sector-specific minimum wages negotiated through tripartite bargaining, as explained in Box 4.2. Even after the important minimum wage increases in these three countries, as Figure 4.7 shows, the minimum wage still represents about 70 percent of the median wage in all three countries, which is below average by regional standards.

Other studies examining the employment effects of minimum wage increases in countries where the minimum wage is set high in the wage distribution report more discouraging results. This is the case in Honduras and Costa Rica, where the “bite” of the minimum wage is higher than in the countries previously discussed, and the literature finds sizable employment reductions following minimum wage increases (Gindling and Terrell 2007, 2009; Ham 2018). There is a need for caution against conclusions such as “the myth of supposed negative effects of the minimum wage has been disproven.” Policymakers should not doubt for a moment that continued increases in the minimum wage that substantially exceed increases in labor productivity will eventually cause trouble. Additionally, it is important that policymakers monitor the possibility of longer-run adjustment margins, as short-run and long-run labor market responses to shocks—in this case, minimum wage increases—can differ substantially (Blyde et al. 2023).

The impact of the minimum wage also depends on enforcement and institutional design. Gindling and Terrell (2007) found no discernible effects on the wages of workers in small firms or the self-employed after increases in Honduras, simply because minimum wages were effectively enforced only in medium- and large-scale firms. Lotti, Messina, and Nunziata (2025) provide cross-country evidence that a high minimum wage is associated with a large self-employment share, thus providing another potential explanation for the excessive self-employment documented in Chapter 2, though mostly in the context of strong enforcement.

Further evidence of the importance of enforcement and compliance comes from Uruguay, where a substantial real increase in the minimum wage—of nearly 80 percent—generated significant wage gains for low-wage workers but had only a limited impact on unemployment. González-Pampillón and Vázquez-Grenno (2025) suggest that noncompliance serves as the adjustment margin for vulnerable firms, particularly when authorities tolerate a lack of enforcement for a long period of time. Lastly, Derenoncourt et al. (2025) find the reallocation effects from formal to informal firms to be relatively modest in Brazil because informal employees in formal firms already “comply” with the minimum wage. They argue that the institutional setting can explain part of this outcome, as there are separate fines for minimum wage violations and the failure to pay social security contributions.

Another important effect of minimum wages on labor outcomes could be reducing inequality; in fact, this is often one of the stated goals of the policy, as in the Brazilian and Mexican cases mentioned above. In almost all countries, higher minimum wages reduce earnings inequality among wage employees (formal and informal). When considering self-employed workers, the evidence is less clear. The minimum wage can even increase inequality when the level is already high (Gindling and Ronconi 2025). For example, a minimum wage increase in Honduras when the minimum wage was already high relative to the wage distribution increased inequality (Ham 2018).

Still another way in which minimum wages may affect outcomes involves the prices in the product market through multiple channels. First, a minimum wage that is set too high can trigger excessive concentration in large firms that are able to withstand higher costs, and this can be counterproductive if the firms end up charging higher prices in the product market and hurting consumers (Lo Bello and Pesaresi 2025). Second, when employment and profits are not affected, higher prices is an obvious response channel. A meta-analysis by Lemos (2008) finds that doubling the minimum wage may increase inflation by 4–10 percent. More recent estimates find a lower but still positive pass-through: a meta-analysis of 199 studies finds that for every 10 percent increase in the minimum wage, prices increase by 0.3–1.1 percent (Pérez Pérez 2026). However, the impact depends on the burden of the minimum wage as a share of total costs. In labor-intensive industries, the price pass-throughs are higher.

Increases can enhance the productivity of workers in large firms with wage-setting power, even when those workers are “exposed” because they earn low wages. Evidence from Uruguay illustrates this mechanism: the institutionalization of sectoral wage bargaining after 2005 led to substantial increases in negotiated minimum wages and produced large reductions in wage markdowns, with smaller increases in prices (Casacuberta and Gandelman 2023). This evidence indicates that employers had significant wage-setting power and that higher (bargained) minimum wages helped compress that gap, thereby reducing employer rents and improving workers’ share of productivity.

Table 4.4 summarizes the most important minimum wage studies in the region in recent years. Most of this information is drawn from a similar table in Gindling and Ronconi (2025), with the addition of results from Argentina as well as the authors’ calculations of the current bite and levels of noncompliance.

TABLE 4.4 MINIMUM WAGE IMPACTS ON LABOR MARKET OUTCOMES

	ARGENTINA	BRAZIL	URUGUAY	MEXICO	COSTA RICA	HONDURAS
Earnings inequality	↓	↓	↓	↓	↓	↑
Lighthouse effect: employees	Yes	Yes	Yes	Yes	Yes	Yes
Lighthouse effect: self-employed	N/A	Yes	No	Yes	No	No
Decrease in covered (formal) employment	No	No	Yes(1)	No	Yes	Yes
Bite: minimum wage/average wage for all workers with 2023 data	60%	50%	50%	50%	70%	130%
Noncompliance: wage workers earning below minimum wage (5) with 2023 data	19%	14%	19%	28%	35%	63%

Source: Authors' elaboration based on data from IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean circa 2023 (bite and noncompliance); Gindling and Ronconi (2025); Gindling and Terrell (2007); IDB (2023).

Note: (1) Although aggregate informality did not increase (González-Pampillón and Vázquez-Grenno 2025), employment effects were concentrated in small firms when enforcement was strengthened. Borraz and González-Pampillón (2017) also find employment outside the capital city and informality increase in places where informality is high, as well as among domestic workers (cf. Katzkowicz et al. 2021). (2) In Brazil, Derenoncourt et al. (2025) do not find a decrease in formal employment, but other studies have shown a correlation between the bite of the minimum wage and informality levels in that country. (3) In Honduras, the informality estimates are proxied based on small private firms; in Costa Rica, they are based on self-employed and unpaid workers. (4) The data for Argentina are based on Groisman (2026). (5) Noncompliance = less than 95 percent of the national minimum wage (monthly). This estimation is a lower bound in countries in which the national minimum wage is less than regional wages (Brazil) or where minimum wages are predominantly determined through collective bargaining structures that cover most formal workers (Uruguay).

Even in countries in which the aggregate effects are small or null, there is a tendency to find negative employment effects when the minimum wage bites more, such as in small firms or low-paying regions. In Latin America and the Caribbean, the bite can be large. On average, 67 percent of workers in small firms in the region³⁴ earn the national minimum wage³⁵ or less, and around 18 percent of workers work in such small firms.

An increase in the minimum wage can enhance productivity by reducing allocative inefficiency, that is, by promoting the reallocation of workers from unproductive firms that cannot afford to pay the higher minimum wage to more productive firms that can. As discussed in Chapter 3, large firms have high wage markdowns, so a high minimum wage can improve efficiency in these firms. Rao and Risch (2024), for example, study the impacts

³⁴. Five or fewer employees, excluding self-employed workers.

³⁵. Plus 10 percent.

of minimum wages in the United States and find that increases in the minimum wage forestall entry, particularly for less-productive firms, thereby reducing the number of independent firms operating in these industries by roughly 2 percent. However, these industries do not shrink; instead, incumbent responses and strong positive selection among entrants reshape industries that rely heavily on low-wage workers, yielding fewer but more productive firms. Engbom and Moser (2022) also find that the potentially negative impact of the minimum wage increases in Brazil was muted by the reallocation of workers toward more productive firms.

To summarize the extensive literature on the effects of the minimum wage, studies suggest that employment elasticity with respect to wages could be small on the national level but larger for highly exposed workers, such as low-wage employees in firms with limited ability to absorb cost shocks. The result generally depends on the level of the minimum wage and the government's capacity to enforce it. An important margin of adjustment is simply noncompliance, especially for small firms, as discussed in Section 4.4 of this chapter. Larger firms can absorb the shock through other margins, such as a pass-through to prices, thereby lowering their profits or other benefits for workers, so the employment effects tend to be smaller than on smaller firms. If workers move from low- to high-productivity firms or increase their bargaining power, minimum wage increases can have positive productivity effects in aggregate.

Lastly, although the minimum wage is an important component of labor costs, it is not the only component. The total labor cost structure includes wages, benefits, social security contributions, and payroll taxes. Evidence of the employment effects of the total labor cost is further explored in Chapter 7.

4.3.7 Why Minimum Wages Are Popular

Survey data indicate that minimum wages are a popular policy even among uncovered workers, such as the unemployed, low-skilled workers, and those without access to legally mandated benefits (Gindling and Ronconi 2025). Several factors may explain this support. First, as discussed, minimum wages have a lighthouse effect, influencing wage-setting beyond legally covered workers by raising reservation wages across the economy. Second, there is a general preference for policies that are perceived as fair, particularly among workers who are not covered and may distrust employers. Additionally, income sharing within households composed of covered and uncovered workers can provide indirect benefits. Moreover, the potential negative effects of minimum wages, as predicted by economic theory, are counterintuitive to many. That said, it would be a mistake either to dismiss support for minimum wages as a mere misunderstanding or to justify their use solely on the basis of popular approval that may not fully reflect their complex effects.

4.4 Enforcing Labor Regulations: From Rules to Reality

Labor legislation is a distinct branch of the legal system, encompassing specific legal institutions that blend elements of both private and public law. This combination gives rise to a specialized body of jurisprudence focused on labor rights and relations. The enforcement of these laws does not depend exclusively on judicial bodies; rather, it involves intervention by executive authorities that exercise supervision and control (Vega Ruiz 2009). An important institution in this matter is government inspection, a role that, in the region, is often overseen by ministries of labor.

Currently, in Latin American and Caribbean countries, labor inspection is usually conducted by a generalist labor inspectorate in the Ministry of Labor that is exclusively responsible for the supervision of labor standards. This supervision entails, among other functions, overseeing working relations, general working conditions, and minimum wage regulation as well as preventing work-related hazards, labor discrimination, and child labor. These enforcement bodies typically focus on labor regulations, while other agencies are responsible for overseeing compliance with social security contributions. There are, however, exceptions in the region, such as Peru, where the agency in charge of overseeing labor inspection also audits, at least partially, social security obligations.

Typically, inspectorates utilize three main strategies that increase in severity: information and advising services, labor inspections, and sanctions. Information and advising services are especially important in Latin America and the Caribbean, as the region's enforcement process is intended to be more collaborative than punitive (Gindling and Ronconi 2025). Labor inspections can be performed on-site by having inspectors visit workplaces to assess compliance or remotely by having inspectors examine company records, payrolls, and contracts. Inspections can be reactive, such as answering a complaint regarding a potential violation of regulation, or proactive, involving routine inspections that can be planned according to a risk assessment. In the region, inspections tend to be reactive. For instance, in Peru, 60 percent of inspections were complaint-based in 2017 (Bosch, González, and Silva-Porto 2021).

In many Latin American and Caribbean countries, enforcement also relies on workplace-level mechanisms such as occupational safety and health (OSH) committees, which include employer and worker representatives to monitor and promote safe working conditions. Recommended by ILO conventions, these committees complement inspectorate efforts by identifying hazards, raising awareness, and supporting compliance before formal inspections take place. Most countries in the region have legislation requiring the establishment of joint OSH committees at the company level (ILO 2023).

It is important to recognize a danger associated with the enforcement of excessively rigid labor regulations. Brotherhood et al. (2024), for example, find that formal firms caught with informal workers face sustained slower growth. Samaniego de la Parra and Fernández Bujanda (2024) find similar results based on randomized labor inspections in Mexico. This evidence is cited to stress the importance of improving labor regulations as well as enforcing them, not to suggest that policymakers should tolerate violations.

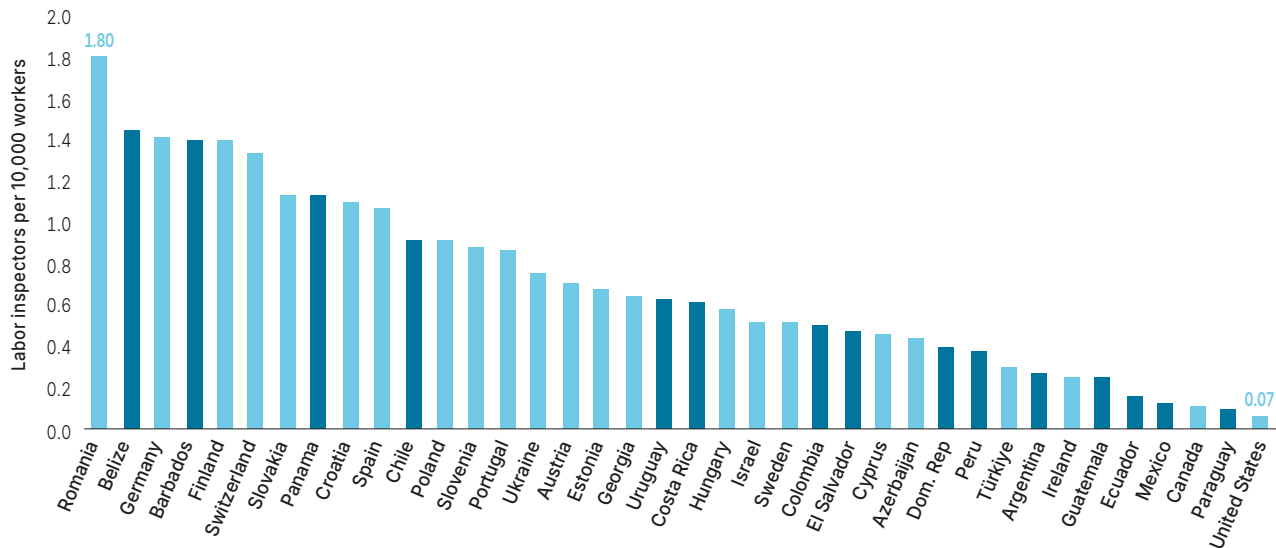
4.4.1 More Than Just Inspectors: The Importance of Enforcement Capacity

In the literature, enforcement capacity in Latin America and the Caribbean is typically proxied by the number of labor inspectors. While this measure provides only a crude approximation of actual capacity—a limitation discussed later in this chapter—it nonetheless reveals that in many countries, inspectors per worker are substantially lower in the region than in advanced economies despite these measurement constraints. There is, however, substantial cross-country variation. For instance, the number of labor inspectors per worker in Panama is 11 times that in Paraguay (Figure 4.11). And, in the region, countries with higher formality levels also tend to have more inspectors per worker (Figure 4.12).

The number of labor inspectors per worker in Panama is 11 times that in Paraguay.

4 Making Labor Regulation Work: Incentives, Protection, and Enforcement

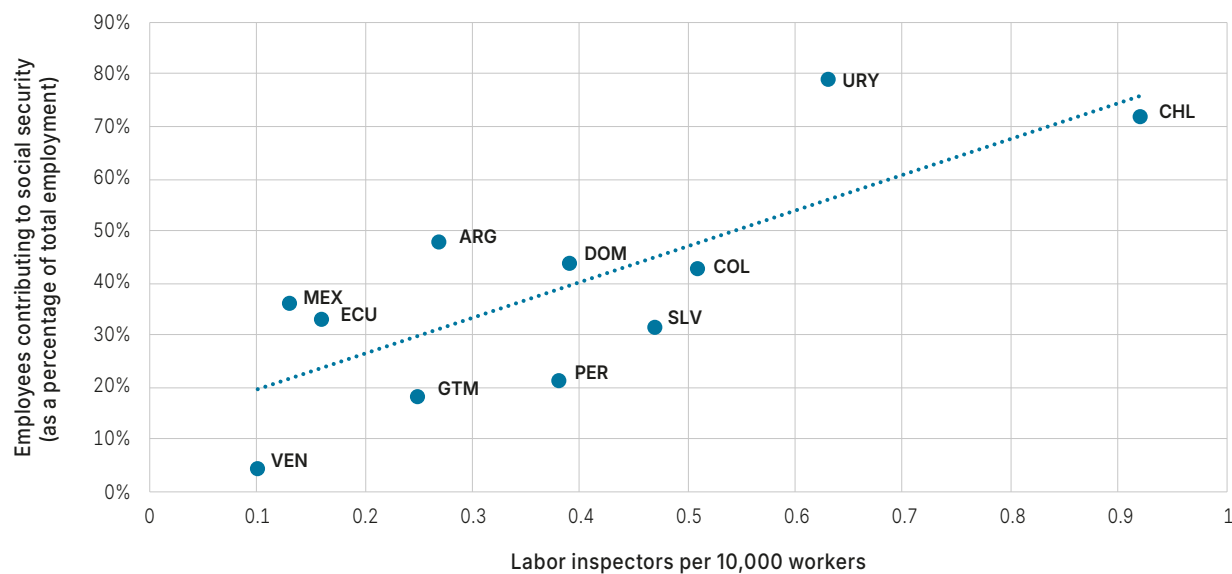
FIGURE 4.11 LABOR INSPECTORS PER 10,000 WORKERS, CIRCA 2023



Source: ILO (using data for 2018 or later).

Note: The ratio of labor inspectors per 10,000 workers in Belize and Barbados is influenced by the relatively small populations of those countries (in 2023, 410,000 in Belize and 281,000 in Barbados).

FIGURE 4.12 NUMBER OF LABOR INSPECTORS AND FORMALITY RATES



Source: ILO and IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: Data on labor inspectors for the Dominican Republic and Venezuela are from 2013.

The number of inspectors is, however, an incomplete measure of enforcement capacity. At least five other factors play a crucial role.

First, training and complementary resources, such as data, are essential. In this regard, enforcement capacity in the region is often limited, as labor inspectors frequently lack proper training and adequate resources to carry out their duties. Insufficient funding for travel and vehicle expenses, as well as inadequate equipment, restricts their ability to conduct on-site inspections. Additionally, weak data analysis and enforcement strategies further reduce effectiveness. For example, in Peru, the main labor inspectorate database includes only registered businesses, covering less than 50 percent of the country's 3.7 million private-sector microbusinesses. By 2017, approximately 20 percent of the contact records in this database were outdated (Bosch, González, and Silva-Porto 2021). Ideally, inspectorates would have access to a database that calculates the probability of various violations given a large set of available information for the purpose of making inspections as effective as possible.

Second, legal frameworks can either support or hinder enforcement agencies. In some cases, legal restrictions create obstacles to effective labor law implementation. For instance, in Peru, before 2020, labor inspection authorities faced limitations in their communication strategies since firms could not be officially contacted by email or electronic portals. Moreover, coordination with other government agencies that maintain reliable administrative records—such as tax authorities or social security institutions—is often missing or insufficient. In extreme cases of poor coordination between labor inspectorates and social security institutions, there may even be different sanctions and fines for employers that fail to register their employees for social security. Costa Rica, El Salvador, Honduras, Paraguay, and Panama are examples of countries in which labor codes set higher fines for employers that fail to provide social security protection to their employees than those set by social security authorities.

Third, the enforcement procedure is a critical factor. Unfortunately, in many Latin American and Caribbean countries, the process of imposing and collecting sanctions is cumbersome, involving multiple agencies and numerous steps and, thus, resulting in low labor fine collection. While labor inspectorates are responsible for recommending penalties, in several countries, including Costa Rica and the Dominican Republic, labor courts or the general justice system are responsible for imposing and collecting fines. These bureaucratic collection procedures not only lead to low fine collection rates but also may create uneven costs for firms, favoring those skilled at navigating or avoiding penalties—which may not necessarily be the most productive. By contrast, in Guatemala and Uruguay, labor inspectorates have the authority to both impose and collect fines.

Fourth, the destination of collected fines also affects enforcement capacity. In many countries, fines are funneled to the general treasury; in Guatemala, they are funneled back to the labor inspectorate, and, in Uruguay and Colombia, they finance training programs. In Peru, at the time of writing, collections from fines are funneled to the treasury, but there are discussions about funneling them to the labor inspectorate, a choice that involves important trade-offs in terms of enforcement capacity. Allowing the inspectorate to retain fines can enhance enforcement capacity by strengthening incentives, improving financial autonomy, and expediting access to resources for operations and training. However, this approach also creates risks of perverse incentives, with inspections becoming revenue-driven rather than compliance-oriented, thereby weakening accountability and eroding trust among employers and workers in the fairness of the system.

Lastly, the understanding of labor regulations among workers, employers, and inspectors—and, hence, their simplicity—is critical. There is suggestive evidence that, in highly complex regulatory systems, employees do not understand basic features, such as the minimum wage that applies to them (Gindling and Ronconi 2025).

4.4.2 Structure of Sanctions

In general, sanctions take the form of monetary fines, though, in some cases, criminal penalties also apply *de jure*. For example, in Mexico, Suriname, and Jamaica, minimum wage violations can result in criminal fines under the law, although such fines are rarely enforced in practice. Most countries determine the value of sanctions based on criteria such as the nature of the infraction, the impact on labor rights, the number of affected workers, and the employer's conduct. However, these classifications are not standardized but vary widely across the region.

The numeraire for financial penalties also varies by country; in some cases, fines are set in absolute monetary terms, as in Panama, while, in others, they are calculated as multiples of the minimum wage, as in Costa Rica, Guatemala, the Dominican Republic, and Colombia. As discussed, indexing fines to minimum wages is a costly practice that can distort the nature of minimum wage negotiations.

4.4.3 Enforcement and Firm Size: Uneven Rules, Distorted Incentives

The firm demographics in the region further compound the challenges associated with enforcement capacity. Enforcing labor regulations in the region is particularly costly because most workers are employed in small firms. For instance, between 2014 and 2017, labor inspectors in Peru visited only 20,000 companies, though the microbusiness sector

alone comprises 3.7 million firms (Bosch, González, and Silva-Porto 2021). Enforcement is correlated with firm size at the global level (Bachas et al. 2019), even in formal firms. According to data from the World Bank (2025), large firms in Latin America and the Caribbean (100+ employees) are twice as likely to be inspected for health and safety as small firms (5–10 employees; 42.5 percent compared with 20.5 percent). This gap is similar to the gap in Europe and Central Asia. The key difference is what happens after the inspection. In Latin America and the Caribbean, only 61 percent of inspected small firms received a formal report,³⁶ compared with 84 percent of large firms, a 23-percentage-point gap. In Europe and Central Asia, more than 80 percent of firms receive a report regardless of size, with very small differences across firm sizes.

Weak enforcement among small firms may create perverse incentives, thereby ultimately hindering aggregate productivity. As in other size-dependent regulations, weak enforcement can contribute to misallocation by creating incentives for firms to remain small or informal. For example, Coppier, Michetti, and Scaccia (2024) show that size-dependent tax enforcement generates economic incentives for unproductive firms to remain small and thus avoid stronger enforcement, which has important macroeconomic implications. Guner, Ventura, and Yi (2008) measure the cost of policies that reduce the size of firms and find that they lead to an increase in small and unproductive firms and important reductions in output and output per firm.

This outcome may be exacerbated by the design of fines, which, in some cases, vary explicitly by firm size. For example, in Chile, a large firm that hires an underage worker faces a fine 18 times that imposed on a small firm, while, in Panama, a large firm that misreports wages can receive a fine four times that imposed on a small firm.³⁷ As discussed below, there is evidence of strategic responses by firms to these disparities in enforcement and penalties. In general, in a region characterized by excessive employment in very small and unproductive firms, any practice that disproportionately benefits small firms, such as low inspection probability, can exacerbate productivity problems by discouraging firm growth.

³⁶. In 2025 or the latest available year.

³⁷. Authors' calculations using sanction schedules established in the labor codes of Chile and Panama.

4.4.4 Strict Rules, Weak Enforcement?

Researchers studying government enforcement efforts in the region have highlighted a potential relationship between the stringency of regulations and enforcement efforts. In contexts characterized by highly stringent regulations, such as very high minimum wages, governments may have incentives to reduce enforcement intensity because of ideological differences among policymakers or because governments seek to balance competing interests by appeasing workers with strict labor laws while simultaneously accommodating employers through limited enforcement (e.g., Gindling and Ronconi 2025). While strong empirical evidence in support of this argument is lacking, some suggestive evidence lends it credibility. For instance, international comparisons indicate that, compared with East Asian countries and the United States, Latin American and Caribbean countries tend to have more protective and rigid employment laws while simultaneously allocating fewer resources to enforcing them (Ronconi 2021). This evidence is consistent with the idea that labor regulation in the region tends to be aspirational rather than a definition of the conditions that firms are expected to meet.

Thus, greater enforcement involves significant trade-offs. Indeed, despite substantial improvements in detection technologies, authorities may tolerate large informal sectors because stricter enforcement could increase unemployment, leading to undesirable social and political consequences (Boeri and Garibaldi 2007). In such cases, as discussed in Chapter 8, it is preferable to adjust the legal framework rather than to attempt to “compensate” for a poorly designed rule through selective or arbitrary enforcement, thereby eroding the rule of law and reducing regulatory credibility.

Labor regulation in the region tends to be aspirational in nature: labor markets are heavily regulated, but resources for enforcement are scarce.

4.4.5 What Happens When Labor Laws Are Enforced?

When investigating the effect of enforcement efforts on labor market outcomes, researchers often distinguish between two margins. The first is the extensive margin, which concerns whether firms register and pay the entry fees required to obtain formal status. The second is the intensive margin, which concerns whether formally registered firms hire workers without a formal contract or fail to comply with labor and social security regulations. Evidence suggests that policies promoting formalization through strengthened enforcement along the extensive margin generally have positive effects on aggregate productivity by reallocating resources

from less to more productive firms and do not increase unemployment (see the literature review by Ulyssea 2020). For instance, Meghir, Narita, and Robin (2015) show that stronger enforcement can lead to higher wages and lower inequality among low-skilled male workers in the state of São Paulo, Brazil. These effects, however, are only viable in contexts with large, productive formal firms capable of absorbing workers displaced from informal sectors.

With respect to enforcement on the intensive margin, evidence shows that these efforts entail important trade-offs in formalization outcomes. This evidence is particularly relevant to policy design since enforcement agencies in the region often concentrate on the intensive margin by targeting firms that are already visible in administrative records. Studies indicate that such strategies can indeed improve outcomes for formal workers but may do so at the expense of formal employment, firm size, or output growth since stronger enforcement effectively raises the costs faced by formal firms (Ulyssea 2020). For example, studies in Brazil and Mexico find that increasing inspections can raise wages and the probability of remaining formally employed among formal workers but can also reduce the share of formal firms and overall formal employment (Almeida and Carneiro 2009, 2012; Almeida, Carneiro, and Narita 2013; Samaniego de la Parra and Fernández Bujanda 2024). Looking at the dynamics, recent evidence from Brazil shows that inspections may initially increase formal employment without affecting firm performance but, over time, can reduce performance and survival, especially in areas with high informality (do Prado, Santos, and Van Doornik 2025).

A more specialized set of studies focuses on outcomes related to occupational safety and health (OSH). This literature—predominantly from advanced economies—finds that stronger enforcement tends to improve OSH outcomes (e.g., Andersen et al. 2019). Emerging evidence from developing countries points in a similar direction. In Brazil, for example, recent research shows that labor inspections reduce the incidence of work-related accidents without prompting firms to misclassify workers or underreport incidents (do Prado 2025). Also, recent experimental evidence from the apparel sector in Bangladesh, where factories supply multinational buyers, highlights the potential gains from strengthening enforcement through OSH committees. Reinforcing these committees led to substantial improvements in objective measures of workplace safety, with especially strong effects in factories that already had strong managerial practices. Importantly, these improvements did not come at the expense of workers—there were no adverse effects on wages or employment—nor did they reduce factories' labor productivity (Boudreau 2024).

Studies have also examined the impact of specific enforcement strategies that, as discussed in Chapter 8, can inform policy design. One line of evidence comes from Spain, where assigning monitoring intensity based on firm size has been shown to induce strategic bunching just below the eligibility threshold, as firms adjust their reported size to avoid stricter

enforcement of tax and social security obligations, and smaller firms, facing weaker oversight, have greater scope to misreport labor and material expenditures to evade multiple taxes (Almunia and Lopez-Rodriguez 2018). Overall, as discussed in Chapter 8, the findings suggest that extending stricter tax monitoring to smaller firms could yield substantial welfare gains. Moreover, to the extent that lower enforcement effectively acts as a subsidy for smaller, less productive firms, these differences in enforcement probabilities may have a negative impact on overall productivity.

A second line of evidence focuses on informational strategies, which are particularly relevant in contexts in which employers and workers may lack knowledge about labor regulations. A recent randomized study in South Africa involved providing small- and medium-sized firms with free access to newsletters and an online portal explaining labor laws and HR guidance. The firms improved their understanding of regulations, became less likely to perceive them as a hiring barrier, and increased hiring significantly, by around 15 percent, primarily in permanent and fixed-term positions. The fact that the effects were strongest among smaller firms suggests that limited knowledge of labor laws can constrain employment even in the absence of stricter inspections. These findings indicate that low-cost interventions that inform firms about labor laws can expand employment, especially when monitoring or managerial capacity is limited (Bertrand and Crépon 2021).

Lastly, a growing body of literature examines enforcement strategies that seek to increase compliance using techniques derived from behavioral economics. The underlying rationale is that compliance is shaped not only by cost-benefit calculations but also by cognitive biases and social pressures. These studies typically assess the effectiveness of low-cost “nudge” interventions—often communication campaigns—that incorporate information on peer behavior, deterrence-oriented content, or increased salience of formalization benefits in order to influence social security and tax payments (e.g., Ortega and Scartascini 2015; Castro and Scartascini 2015; Hallsworth et al. 2017). The evidence shows that such strategies can change behavior at very low cost, though their effectiveness varies by context (see, for instance, Slemrod 2019 for a review of impacts on taxpayers' behavior). Importantly, their experimental design allows enforcement agencies to compare the relative impact of alternative approaches that directly inform policy design.

In Latin America, for example, an IDB study with Peru's *Superintendencia Nacional de Fiscalización Laboral* [National Superintendence of Labor Inspection] (SUNAFIL) randomly sent firms either a deterrence-style letter or one highlighting the benefits of formalization. One year later, large firms that received the deterrence message increased the number of workers enrolled in social security by 9.8 percent, while the benefits-oriented message had no effect, and small firms did not respond to either treatment (Bosch, González, and Silva-Porto 2021).

These findings informed SUNAFIL's enforcement strategy and illustrate how integrating experimental evidence into institutional practice can help agencies refine and adjust their approaches based on what works.

4.5 Weak Unions, Strong Role: Organized Labor and Collective Bargaining

The economic rationale for labor unions arises from the well-documented disparities in bargaining power between workers and firms. Historically, organized labor has been highly effective in securing essential protections for workers and has played a crucial role in reducing transaction costs in industrial relations. By coordinating collective bargaining, unions streamline negotiations and help reduce the costs of reconciling the interests of employers and workers.

Union density, defined as the percentage of employed workers who are members of trade unions relative to the total number of workers, is low in the region compared with global averages, though there are significant differences across countries. Whereas, in high-income nations, the average union density is around 30 percent, in most Latin American and Caribbean countries, labor unions remain relatively weak, with union density hovering around 10 percent. However, countries such as Uruguay, Argentina, and Costa Rica report rates similar to those in high-income countries, exceeding 20 percent. Caribbean nations with large public sectors also tend to have high unionization rates (Table 4.5). Moreover, the collective bargaining coverage rate indicates that union agreements set the pay and working conditions of up to 64.8 percent of workers in Brazil and 49.4 percent in Argentina. In most other countries, however, collective bargaining agreements cover a substantially smaller share of the workforce.

Nearly 80 percent of people across Latin America and the Caribbean—including informal, self-employed, and unemployed workers—believe that unions play an essential role in worker representation.

TABLE 4.5 ORGANIZED LABOR INDICATORS

COUNTRY	LABOR UNION DENSITY (%) ⁽¹⁾	COLLECTIVE BARGAINING COVERAGE RATE (%) ⁽²⁾	UNION TRUST (%) ⁽³⁾
Argentina	27.7	49.4	25.0
Belize	7.4	9.1	
Bolivia	12.1		34.4
Brazil	13.0	64.8	39.2
Chile	17.1	21.0	42.5
Colombia	4.6	15.7	34.2
Costa Rica	20.5	11.8	31.3
Dominican Republic	8.3		33.3
Ecuador			29.3
El Salvador	8.7	4.6	32.7
Guatemala	2.9		30.1
Guyana	14.0		
Haiti	1.7		
Honduras	2.6	1.9	28.3
Mexico	13.1	10.4	32.9
Panama	26.3	2.0	23.0
Paraguay	4.3	0.7	32.0
Peru	2.3	2.6	25.8
Trinidad and Tobago	19.8	19.9	
Uruguay	30.1	94.7	44.4
Venezuela	0.2	23.4	22.3

Source: Authors' elaboration using data from ILOSTAT, Corporación Latinobarómetro, and Socio-Economic Database for Latin America and the Caribbean (SEDLAC).

Note: The dates are as follows. (1) The percentage of employed workers who are members of trade unions relative to the total number of workers: ARG 2014, BLZ 2019, BOL 2019, BRA 2019, CHL 2018, COL 2024, CRI 2019, DOM 2024, SLV 2018, GTM 2022, GUY 2018, HTI 2012, HND 2017, MEX 2024, PAN 2019, PRY 2024, PER 2018, TTO 2013, URY 2013, VEN 2012. (2) The share of workers with pay and working conditions set by union agreements: ARG 2018, BLZ 2012, BRA 2020, CHL 2018, COL 2016, CRI 2020, SLV 2018, HND 2016, MEX 2019, PAN 2017, PRY 2016, PER 2020, TTO 2020, URY 2018, VEN 2016. The data for Paraguay, Mexico, Guatemala, the Dominican Republic, and Colombia are taken from Socio-Economic Database for Latin America and the Caribbean; the data for the rest of the countries are taken from the ILO. (3) The percentage of respondents having "much" or "some" confidence in unions: 2023, all countries (source: Corporación Latinobarómetro).

Unionization rates vary significantly across economic sectors, with notably higher union density in the public sector than in the private sector. On average, unionization in the public sector is three times that in the private sector. Unionization also differs by firm size, with larger firms exhibiting higher union densities (Ronconi 2021). This relationship is partly due to structural factors: larger firms employ more workers, thereby creating a greater need for organization and coordination. More importantly, larger firms tend to be more productive and generate higher profits, providing unions with greater leverage to negotiate for redistribution.

In Latin America and the Caribbean, union density has declined steadily over the past few decades. However, exceptions to this trend include modest increases in unionization in Brazil and Chile. Some studies also suggest that unions regained power in Argentina during the 2000s compared with the 1990s, although their influence remains far below earlier levels (Ronconi 2021).

This decline can be attributed to several factors, including the shift from industry-level bargaining in the 1980s toward more decentralized negotiations. This shift also coincided with a shrinking labor market in traditionally unionized sectors, such as manufacturing, as well as the rise in the use of temporary contracts described above. Additionally, the decline in unionization may be attributable to illegal or unconstitutional efforts to suppress union activities. Although many countries in the region constitutionally protect the right to organize, unions continue to face substantial challenges. Violations of freedom of association and collective bargaining rights are more prevalent in Latin America and the Caribbean than in Europe, Canada, or the United States, with considerable variation across the region. Such violations are uncommon in Caribbean nations and Uruguay but occur in countries such as Guatemala, Peru, and Colombia (Ronconi 2021).

Beyond the structural and economic factors, issues of perception and trust may also contribute to the decline in unionization. Confidence in unions among Latin Americans has been consistently low and has declined over time. In 1995, 33 percent of people reported having “much” or “some” confidence in unions, but, by 2024, this figure had dropped to just 25 percent (Corporación Latinobarómetro 2024). In fact, when comparing public trust across institutions, trade unions in Latin America and the Caribbean are perceived as less trustworthy than private businesses and banks (Keefer and Scartascini 2022). Moreover, survey data from Latinobarómetro suggest that corruption perceptions further erode trust in unions: on a scale from 0 to 10, with 0 representing no corruption, 70 percent of respondents rated corruption levels between 6 and 10 (Ronconi 2021).

However, this widespread mistrust does not imply that people oppose the existence of unions. On the contrary, support for labor unions remains strong. Nearly 80 percent of people across Latin America and the Caribbean—including informal, self-employed, and unemployed workers—believe that unions play an essential role in worker representation (Ronconi 2021). Thus, even workers outside formal employment value unions, likely because they see them as institutions that advocate for better working conditions overall. This suggests that, while people in the region recognize the importance of workers' representation, they are critical of union leadership, perceive issues with mismanagement and representation, and distinguish between unions as an ideal and the manner in which they currently operate.

Thus, as discussed in the recommendations in Chapter 8, there is a need to strengthen policies that make unions more representative of workers' interests. Reinforcing collective bargaining could be particularly important in this regard. In Latin America and the Caribbean, some economic sectors apply automatic extension clauses whereby the outcomes of negotiations between unions and employers are extended to nonunionized workers. Data on this practice are scarce, as it is often not reported. Still, Table 4.5 shows that, in the countries for which data are available, the share of workers covered by collective bargaining agreements is relatively low and does not necessarily align with union density.

Considering innovative forms of organized labor could be particularly important for platform workers. As discussed, the evidence shows that platform workers often face limited autonomy and new forms of subordination. Research also indicates that large ride-sharing platforms can exert significant monopsony power to suppress workers' earnings (Fisher 2024). Moreover, a recent ILO study covering platform workers in 14 European countries finds substantial interest in collective organization that has not yet materialized. Although two-thirds of platform workers view unions positively, actual union density remains low, at around 13 percent, and many of these unionized workers were already members of traditional unions before joining the platform economy (Vandaele, Piasna, and Zwysen 2024). However, given that the nature of the tasks, risks, and challenges faced by many platform workers can differ substantially from that of conventional employment, it is important to consider alternative, nontraditional forms of organization to support them. Accordingly, as discussed in the recommendations in Chapter 8, it is essential to promote alternative forms of collective representation tailored to these workers. Such approaches may include digital networks that aggregate workers to coordinate bargaining, share information, and provide mutual support, as well as advocacy groups and NGOs that represent platform workers' interests in policy discussions and help enforce labor standards.



5

Social Security: Balancing Protection and Incentives



THIS CHAPTER IN **FIVE** POINTS

- 1 Access to social security is mostly tied to employment status, excluding many nonsalaried workers.** Because systems in the region are largely financed through employer-employee contributions, self-employed and informal workers have much lower access to contributory benefits, especially pensions and health insurance.
- 2 Social security contributions finance services often unrelated to employment, while their perceived value is frequently below their cost.** In many countries, contributions fund health insurance, housing, family allowances, solidarity transfers, and other social services. Weak service quality, redistribution, behavioral biases, and similar noncontributory benefits can reduce perceived value, creating a tax wedge that discourages formal employment.
- 3 Special tax and social security regimes designed to promote formalization can distort labor markets and productivity.** Regimes for small firms and the self-employed, as well as preferential tax treatment for large firms, affect the cost of formal labor and may encourage underreporting or evasion. Although they can reduce compliance costs, their effects on productivity, firm growth, and aggregate formal employment remain uncertain.
- 4 The region has greatly expanded old-age protection, mainly through noncontributory pensions.** Around 60 percent of people over 65 now receive a pension: 32.5 percent through contributory schemes and 27.6 percent through noncontributory programs, up from 34 percent two decades ago. However, contributory coverage remains limited because many workers do not accumulate sufficient contribution histories.
- 5 Unemployment protection remains one of the weakest components of social protection in the region.** Unlike most OECD countries, which rely mainly on unemployment insurance, most countries in the region use severance payments and, to a lesser extent, individual savings accounts. These mechanisms offer limited risk pooling, restrictive eligibility, and low coverage, leaving many workers exposed to income shocks.

5.1 A Model Built for a World of Salaried Labor

This chapter presents an analysis of the set of instruments that provide protection to workers from various economic and social risks, including job loss, workplace accidents, health issues, and the risk of outliving their retirement savings. At the center of this protection framework is social security, which comprises a set of risk-management instruments intended to mitigate the impacts of shocks on well-being by providing financial support to individuals in times of hardship, such as old age, disability, illness, or unemployment.

Although social security often addresses risks that are not strictly work-related, access to these benefits is generally tied to employment status. For example, in countries such as Bolivia, Guatemala, Mexico, and Paraguay, social security contributions are mandatory only for salaried workers, while self-employed workers are not required to contribute. In other countries, self-employed individuals are also required to contribute, but often do not because of the practical challenges of enforcing contributions outside the salaried labor relation (Azuara et al. 2023).

As discussed in Chapter 3, social security systems in the region largely follow a Bismarckian model centered on salaried workers, financed by wage-based contributions, and linked to the contribution history of employees. In Latin America, this model emerged in the first half of the twentieth century, reflecting limited administrative capacity and tax bases, which made universal coverage not feasible, and serving as a mechanism for income redistribution from employers to workers during economic hardship. In the English-speaking Caribbean, social security systems were established later, mostly during the independence movements of the 1960s and 1970s, but similarly adopted a Bismarckian design focused on salaried labor.

The consequences of this design are significant. For instance, as shown in Chapter 2, self-employed workers still have considerably lower social security coverage than salaried workers, and this difference has important implications for both productivity and equity. The following sections examine in greater detail the institutional arrangements that shape social security and the resulting coverage gaps across various types of employment.

5.2 The Wedge Between the Costs and Benefits of Social Protection

There is a vast body of literature analyzing how the design of Bismarckian social security systems can influence the demand for formal labor. As discussed by Levy (2008) and Pagés, Rigolini, and Robalino (2013), if workers do not find the benefits of social security valuable, they prefer to forgo them entirely or purchase a smaller set of benefits. In this situation, social security contributions are perceived as a gap, or wedge, between the cost of labor and the perceived value of benefits to workers. The existence of this wedge depends on whether workers, given the choice, would opt out of contributing.

When workers value benefits below what they pay for them, social security contributions become a wedge between the cost of labor and its perceived worth—a tax on formality.

One well-studied case takes place when behavioral biases, such as present bias (myopia), lead individuals to undervalue long-term financial security, making pension contributions seem like a tax rather than a benefit.

Another example occurs when social security includes redistributive features, such as cross-subsidies from higher-income to lower-income workers, which may not be equally valued by all contributors. Perceived poor service quality is another case; for example, workers who view the training institutions funded by their contributions as ineffective may prefer private training providers instead. Another case arises when the system requires uniform contributions to finance benefits that are valuable only to a subset of workers. For example, contributions

for maternity benefits and childcare services may be highly valued by workers of childbearing age but perceived as a tax by others who do not directly benefit from them. Lastly, if noncontributory social insurance programs operate alongside contributory systems that offer similar benefits, workers are likely to perceive contributions as a tax wedge.

This wedge reduces the incentives for firms to hire formally since employers cannot pass the cost of insurance on to workers through lower wages. Moreover, workers, whether self-employed or not, have reduced incentives to contribute. Given the government's limited enforcement capacity, workers' and employers' diminished incentives to contribute lead to informal work arrangements.

Thus, an examination of the impact of social insurance on labor markets must go beyond simply assessing the monetary costs of contributions. It is also essential to consider the nature of the risks being covered and the value that workers place on social insurance. This is the approach taken in the following sections. And, based on this analysis, Chapter 8 presents specific recommendations. To preview one of the conclusions, one key principle emphasized in Chapter 8 is that improving access to social insurance while minimizing labor market distortions begins with ensuring that risks affecting all citizens, regardless of their labor market conditions, are financed through sources that are not tied to an individual's labor market status—unlike employer-employee contributions.

5.3 Structure of Social Security Benefits and Contributions

Table 5.1 provides a detailed summary of mandatory benefits across the region, organized by contributions from employees, employers, and the self-employed, as well as benefit types (e.g., family allowances, health insurance, and pensions). Five patterns are worth highlighting:

1. Reflecting the Bismarckian legacy, salaried employees participate more comprehensively in social security than self-employed individuals, with mandated contributions to pensions, health, work risk, and, sometimes, unemployment insurance. Self-employed individuals, by contrast, typically have only limited mandatory contributions, primarily for pensions. In several countries, especially in Central America, as well as Paraguay and Peru, self-employed workers are entirely exempt from the mandatory contributory social security system.
2. Pension contributions are the most universally mandated benefit across all groups (employees, employers, and self-employed), whereas other benefits—such as health, life, and unemployment insurance—vary widely by country.
3. From a statutory perspective, employers are typically the primary contributors to social security, with most countries mandating employer funding for at least pensions and health insurance and often extending it to additional benefits. In some countries, such as Mexico and Costa Rica, social security is financed through a tripartite contribution system, in which the government also contributes to workers' pension funds and to health or work-risk insurance, in addition to the contributions of employers and employees.

4. Contributions frequently fund services beyond traditional social insurance, especially in the case of employers' contributions. In many countries, these contributions extend to training and family allowances as well as diverse solidarity programs (e.g., housing subsidies in Venezuela and Mexico, public education taxes in Panama, noncontributory social benefits in Costa Rica, and catastrophe funds in Barbados).
5. There are significant variations across countries in the range of benefits provided and the distribution of the financial burden between employers and workers. Some countries, particularly in the English-speaking Caribbean, have comprehensive mandates that cover a wide range of benefits and are financed by both employers and employees. By contrast, other countries, such as Peru, offer a much narrower set of benefits and mainly require employers to contribute. These differences reflect varying levels of social welfare priorities and economic strategies across the region.

Thus, a wide range of social programs is largely funded through workers' contributions and, even more frequently, employers' contributions. According to historical accounts, this approach emerged in the region because of employers' greater capacity to collect contributions compared with that of governments (Kaplan and Levy 2014). Given the challenges governments faced in tax collection, financing social services through firms at the time of payment appeared to be a more practical and effective solution.

The financing model that links social protection to salaried labor has had significant implications for the structure of labor markets in the region. By increasing the relative cost of salaried employment, this model influences firm size and the distribution of workers between wage employment and self-employment.

By tying social protection to salaried labor, the financing model raises the cost of formal employment—shaping firm size and pushing workers between wage jobs and self-employment.

Moreover, this system limits the scope and accessibility of protection against various risks. While it is reasonable for employment-related risks, such as occupational hazards, to be tied to specific job types, broader protections, such as access to health care, should be universally available. This model also raises equity concerns, as many high-earning self-employed workers tend not to contribute to the financing of these essential services. Their limited participation in supporting universal programs such as health care further constrains the funding of these fundamental protections.

TABLE 5.1 MANDATORY CONTRIBUTIONS MATRIX, CIRCA 2023³⁸

	EMPLOYEE CONTRIBUTIONS								EMPLOYER CONTRIBUTIONS								SELF-EMPLOYED CONTRIBUTIONS							
	Family Allowance	Health	Life Insurance	Pensions	Training	Unemployment	Work Risk	Others	Family Allowance	Health	Life Insurance	Pensions	Training	Unemployment	Work Risk	Others	Family Allowance	Health	Life Insurance	Pensions	Training	Unemployment	Work Risk	Others
ARG																								
BHS																								
BLZ																								
BOL																								
BRA																								
BRB																								
CHL																								
COL																								
CRI																								
DOM																								
ECU																								
GTM																								
GUY																								
HND																								
JAM																								
MEX																								
PAN																								
PER																								
PRY																								
SLV																								
SUR																								
TTO																								
URY																								
VEN																								

● More than one solidarity component
 ● Contains at least one solidarity component
 ● Finances individual benefit

Source: Authors' calculations using data from national legislation and International Social Security Association (ISSA) 2023 country profiles.

Note: In Chile, since 2019, certain self-employed workers earning at least five minimum wages must contribute to social security. Until 2028, they may contribute at reduced rates in exchange for reduced benefits.

³⁸ The analysis focuses on employer and employee contributions while taking into account the fact that, in some countries, the government also contributes to social security.

Pension contribution rates for the Latin America and the Caribbean region (12.7 percent) are, on average, significantly lower than the OECD average (21.6 percent). There are, however, significant disparities among countries (Table 5.2). For example, countries in the Southern Cone have notably high contribution rates that exceed both the region and OECD averages. Brazil leads the region with a contribution rate of 29 percent,³⁹ followed by Paraguay with a rate of 23 percent and Uruguay with a rate of 22.5 percent. By contrast, some countries in the Caribbean and Central America, such as Jamaica, Honduras, and Guatemala, report contribution rates of 6 percent or less. In general, statutory rates are higher for employers than employees and are higher in pension systems based on defined benefit (DB) plans than in those based on defined contribution (DC) plans.⁴⁰

Mandatory employer–employee health contributions are less common than pension contributions but remain widespread. In Latin America and the Caribbean, 20 of 26 countries (77 percent) include health insurance contributions in their social security systems for workers. Of these 20, 19 finance them through contributions for the average worker; Colombia is the exception, excluding health contributions for workers earning less than 10 times the minimum wage. In the remaining countries—mainly in the Caribbean, along with Venezuela—mandatory social security contributions cover job-related health risks rather than health insurance in general. Financing health insurance through contributions for the average worker is also the practice in 17 of the 31 OECD countries outside Latin America and the Caribbean.⁴¹

The average mandatory health contribution rate in the region is 8.6 percent, exceeding the OECD average of 6.5 percent. There is significant variation across countries, however, with rates ranging from 2.5 percent in Barbados to 14.8 percent in Costa Rica. As with pension programs, statutory contribution rates in health programs are typically higher for employers than for employees.

³⁹. For workers with an average income.

⁴⁰. DB plans promise a retirement income based on a formula tied to the worker's contribution history. DC plans specify a set contribution rate without guaranteeing a fixed retirement benefit, so the benefits depend on contributions and any potential returns.

⁴¹. In this estimate, "OECD countries" do not include the LAC countries in the OECD. Belgium and Estonia are also excluded from this estimate, despite having health contributions, because the contributions are applicable only to large firms or workers earning above a specific threshold, which is above the average wage.

TABLE 5.2 MANDATORY PENSION AND HEALTH CONTRIBUTION RATES FOR WAGE WORKERS, 2023 OR LATEST AVAILABLE YEAR

COUNTRY AND TYPE	PENSION CONTRIBUTION RATES			HEALTH CONTRIBUTION RATES		
	CONTRIBUTION RATE	EMPLOYER	EMPLOYEE	CONTRIBUTION RATE	EMPLOYER	EMPLOYEE
Antigua and Barbuda (DB)	14.5%	8.3%	6.3%	7.0%	3.5%	3.5%
Argentina (DB)	21.8%	10.8%	11.0%	13.6%	6.0%	7.5%
Bahamas (DB)	11.3%	6.7%	4.7%	Included, job-related only		
Barbados (DB)	13.5%	6.8%	6.8%	2.5%	1.0%	1.5%
Belize (DB)	10.0%	7.0%	3.0%	Included, job-related only		
Bolivia (DC)	15.7%	3.0%	12.7%	10.0%	0.0%	10.0%
Brazil (DB) ⁽²⁾⁽⁵⁾	29.0%	20.0%	9.0%	0.0%		
Chile (DC)	10.0%	10.0%	0.0%	7.0%	7.0%	0.0%
Colombia (DB)	16.0%	12.0%	4.0%	4.0%	0.0%	4.0%
Colombia (DC) ⁽³⁾	11.5%	8.6%	2.9%			
Costa Rica (DB)	9.6%	5.4%	4.2%	14.8%	5.5%	9.3%
Costa Rica (DC)	4.3%	3.3%	1.0%			
Dominican Republic (DC)	10.0%	7.1%	2.9%	10.1%	3.0%	7.1%
Ecuador (DB)	10.5%	3.8%	6.6%	5.2%	0.0%	5.2%
El Salvador (DB)	16.0%	8.8%	7.3%	10.5%	3.0%	7.5%
El Salvador (DC)	10.0%	2.8%	7.3%			
Guatemala (DB)	5.5%	3.7%	1.8%	6.0%	2.0%	4.0%
Guyana (DB)	14.0%	8.4%	5.6%	Included, job-related only		
Haiti (DB)	12.0%	6.0%	6.0%	6.0%	3.0%	3.0%
Honduras (DB)	3.0%	2.0%	1.0%	7.5%	2.5%	5.0%
Jamaica (DB)	6.0%	3.0%	3.0%	Included, job-related only		
Mexico (DB+DC) ⁽²⁾⁽⁴⁾	7.1%	6.0%	1.1%	7.9%	6.9%	1.0%
Panama (DB+DC)	13.5%	4.3%	9.3%	8.5%	0.5%	8.0%
Paraguay (DB)	23.0%	14.0%	9.0%	Included in pension contribution		
Peru (DB)	13.0%	0.0%	13.0%	9.0%	9.0%	0.0%
Peru (DC)	10.0%	0.0%	10.0%			

COUNTRY AND TYPE	PENSION CONTRIBUTION RATES			HEALTH CONTRIBUTION RATES		
	CONTRIBUTION RATE	EMPLOYER	EMPLOYEE	CONTRIBUTION RATE	EMPLOYER	EMPLOYEE
Suriname (DB)	7.0%	3.5%	3.5%	Included in pension contribution		
Trinidad and Tobago (DB)	13.2%	8.8%	4.4%	Included, job-related only		
Uruguay (DB+DC)	22.5%	7.5%	15.0%	9.5%	4.5%	5.0%
Venezuela (DB)	13.0%	9.0%	4.0%	Included, job-related only		
Non-LAC OECD average (2023)	21.6%	13.4%	8.2%	6.5%	3.2%	3.3%
LAC average	12.7%	7.0%	6.0%	8.6%	3.4%	5.3%

Source: Pension contribution rates were sourced directly from national laws and regulations governing social security published by the ministries of labor and social security in each country. Health contribution rates were sourced from national laws and regulations and the International Social Security Association (ISSA). OECD estimates are based on OECD (2023).

Note: (1) The analysis focuses on employer and employee contributions while taking into account the fact that, in some countries, the government also contributes to social security. (2) Brazil and Mexico have progressive pension rates; the rate that is commensurate with average income was chosen for this table. (3) In Colombia, the contribution percentages for employers and employees are estimated based on the percentage of the contribution rates that goes into the Minimum Pension Guarantee Fund. Employers are only required to pay an 8.5% health contribution for employees earning more than 10 times the monthly minimum wage. Since fewer than 5% of workers typically meet this threshold, most firms effectively do not contribute to health benefits. (4) In Mexico, health contributions are calculated based on the monthly *Unidad de Medida y Actualización* [Unit of Measurement and Update], and the rate is estimated based on the average wage of a formal salaried worker. (5) The payroll tax in Brazil allows an exemption for certain sectors to replace the 20% employer contribution on salaries with the *Contribuição Previdenciária sobre a Receita Bruta* [Social Security Contribution on Gross Revenue] (CPRB), at rates ranging from 1% to 4.5%, depending on the industry. In 2024, this law was temporarily extended but introduced a transitional regime that gradually reinstates the full contribution for companies. By 2028, the employers' contribution will return to the full 20% of payroll, fully replacing the CPRB.

5.3.1 Adjustments to Social Security Contributions

From 2013 to 2023, 15 of the 25 countries in Latin America and the Caribbean that were studied implemented parametric changes to their social security contribution rates for the average worker. The total pension contribution rates from employers and employees increased in 11 of 25 countries, including 6 of the 7 Caribbean countries in the sample. The largest increases were observed in the Caribbean countries of Antigua and Barbuda (4.5 percentage points) and Suriname (4 percentage points), followed by El Salvador and Costa Rica (around 3 percentage points each).

By contrast, health contribution rates remained unchanged for most countries except for slight decreases in Ecuador and Mexico (less than 1 percentage point each). Between 2013 and 2023, other mandatory costs changed only marginally. They increased slightly in Colombia,

Costa Rica, Argentina, and Chile—by 0.2 to 0.4 percentage points—and declined slightly in Peru, Ecuador, and Jamaica, while remaining unchanged in most other countries. Table 5.3 presents the changes in parametric rates over this period.

Beyond core social security contributions, most countries in the region impose “other mandatory costs” that finance a variety of sectoral or institutional programs. These costs include charges such as professional risk insurance, disability insurance, and funds for training institutions, unemployment insurance, or mandatory individual accounts. Employers primarily bear these charges. In 2023, employees contributed an average of 1.7 percent of their base wage, while employers contributed 6.9 percent (Alaimo, Altamirano, and Minaya 2026).

TABLE 5.3 CHANGES IN TOTAL CONTRIBUTION RATES (EMPLOYER + EMPLOYEE), 2013–2023

COUNTRY	2023				2013				TOTAL CHANGE (PERCENTAGE POINTS)
	PENSIONS	HEALTH	OTHERS	INDIVIDUAL ACCOUNTS	PENSIONS	HEALTH	OTHERS	INDIVIDUAL ACCOUNTS	2023 VS. 2013
Antigua and Barbuda	14.5%	7.0%	0.0%	0.0%	10.0%	7.0%	0.0%	0.0%	4.5
Suriname	7.0%		0.0%	0.0%	3.0%		0.0%	0.0%	4.0
El Salvador	16.0%	10.5%	1.0%		13.0%	10.5%	1.0%		3.0
Costa Rica	13.9%	14.8%	8.3%	1.5%	9.1%	14.8%	8.0%	3.0%	2.7
Peru	13.0%	9.0%	0.6%	10.0%	13.0%	9.0%	0.7%	8.3%	1.6
Trinidad and Tobago	13.2%				11.7%				1.5
Belize	10.0%			0.0%	9.0%			0.0%	1.1
Argentina	21.8%	13.6%	6.6%		21.2%	13.6%	6.3%		0.9
Jamaica	6.0%	0.0%	13.5%		5.0%	0.0%	13.8%		0.7
Bahamas	11.3%			0.0%	9.0%		1.8%	0.0%	0.5
Colombia	16.0%	4.0%	4.7%	8.3%	16.0%	4.0%	4.3%	8.3%	0.4
Chile	10.0%	7.0%	6.9%		10.0%	7.0%	6.7%		0.2
Barbados	13.5%	2.5%	3.9%	0.0%	15.9%		3.8%	0.0%	0.2
Mexico	7.1%	7.9%	8.0%		6.3%	8.7%	8.0%		0.0
Honduras	3.0%	7.5%	4.2%		3.0%	7.5%	4.2%		0.0
Ecuador	10.5%	5.2%	5.0%	8.3%	9.7%	5.7%	5.2%	8.3%	0.0
Venezuela	13.0%		8.8%		13.0%		8.8%		0.0
Bolivia	15.7%	10.0%	1.7%	0.0%	15.7%	10.0%	1.7%	0.0%	0.0

COUNTRY	2023				2013				TOTAL CHANGE (PERCENTAGE POINTS)
	PENSIONS	HEALTH	OTHERS	INDIVIDUAL ACCOUNTS	PENSIONS	HEALTH	OTHERS	INDIVIDUAL ACCOUNTS	2023 VS. 2013
Dominican Republic	10.0%	10.1%	2.7%	0.0%	10.0%	10.1%	2.7%	0.0%	0.0
Guatemala	5.5%	6.0%	6.0%	0.0%	5.5%	6.0%	6.0%	0.0%	0.0
Panama	13.5%	8.5%	3.2%	1.9%	13.5%	8.5%	3.2%	1.9%	0.0
Uruguay	22.5%	9.5%	7.1%	0.0%	22.5%	9.5%	7.1%	0.0%	0.0
Guyana	14.0%			0.0%	14.0%			0.0%	0.0
Paraguay	23.0%		2.5%	0.0%	23.0%		2.5%	0.0%	0.0
Brazil	29.0%		6.0%	8.0%	29.0%		6.2%	8.0%	-0.2

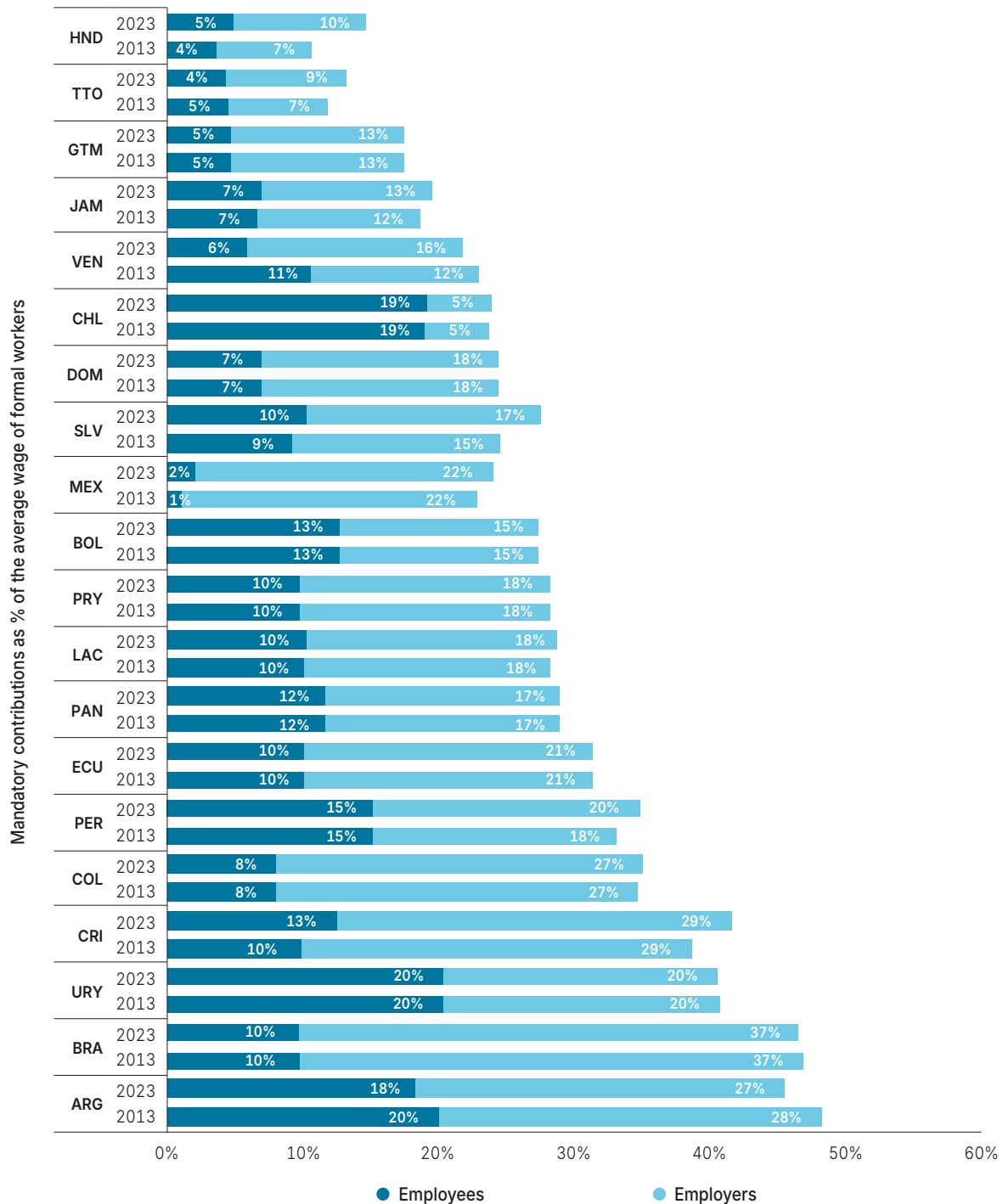
Source: The 2013 information is based on Alaimo et al. (2017) and the ISSA for Caribbean countries. Information for 2023 is based on national laws and regulations governing social security in each country.

Note: (1) The analysis focuses on employer and employee contributions while noting that, in some countries, the government also contributes to social security. (2) Mexico's health contribution rates are estimated based on the average formal workers' base wage. Panama's individual account is managed through a severance pay fund. (3) In Uruguay, health contribution rates are based on income and family composition; the rates shown assume a single worker earning less than 2.5 times the base wage. (4) Brazil and Mexico have progressive pension rates; shown here is the rate that is commensurate with the average income in 2023.

A comparison of only the changes in the contribution rates does not completely reveal the effective rate because the base salary for social security contributions often varies by country. In some countries, the taxable base is calculated using the net wage, while, in others, it is calculated using the gross wage, which includes the base salary plus bonus payments. Figure 5.1 illustrates the evolution of the effective rate (as a percentage of the base wage) for employers and for employees who earn the average wage, as mandated by law, from 2013 to 2023. Generally, employers are expected to pay the largest share of mandated contributions. In 2023, the mandated contributions for employers amounted to 18.5 percent of average annual wages (an increase of 0.6 percentage points compared with 2013), compared with 10.2 percent for employees, which remained unchanged. While seven countries increased their mandatory contributions for employers, only four countries did so for employees.

5 Social Security: Balancing Protection and Incentives

FIGURE 5.1 CHANGES IN MANDATORY CONTRIBUTION RATES AS A PERCENTAGE OF THE BASE WAGE, 2013–2023



Source: Alaimo, Altamirano, and Minaya (2026).

5.3.2 The Challenge of Covering the Self-Employed

Most statutory social security programs in the region are contributory and primarily designed for salaried workers. However, over the past two decades, many countries in the region have extended legal contribution obligations to independent workers. In countries where social security contributions are mandatory for independent workers, the average combined pension and health contribution rate is 15 percent (Table 5.4), which is lower than the average employer-employee contribution rate of 18.2 percent (Alaimo, Altamirano, and Minaya 2026).

In practice, enforcing compliance among self-employed workers is more challenging than among wage workers because of greater income instability and lower traceability of labor earnings. Unsurprisingly, a significant portion of social security enforcement efforts in the region focus on detecting and ensuring compliance among the self-employed when it is mandated by law. In the English- and Dutch-speaking Caribbean, self-employed workers are generally included in social security schemes, as seen in the national insurance programs of Barbados, Belize, Guyana, Jamaica, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago. These schemes cover a broad range of short- and long-term risks, including sickness, maternity, injury, disability, and old age.

However, challenges remain when it comes to ensuring the participation of self-employed workers in social insurance systems. Some issues stem from governance structures. Despite their significant contribution potential, self-employed workers are excluded from formal representation on the boards of national insurance agencies, which are typically defined by law and follow a tripartite structure representing the government, employers, and employees. Operational challenges also persist. For example, in Trinidad and Tobago, while the National Insurance Board states that self-employed workers are covered, the existing procedures do not allow them to contribute in practice. By contrast, Jamaica has implemented a system in which self-employed social insurance contributions are reported through individual tax returns and managed by the tax authority (González-Velosa, Villa, and García-Huitrón 2026).

TABLE 5.4 MANDATORY CONTRIBUTION RATES OF INDEPENDENT WORKERS, 2023

COUNTRY	TYPE OF HEALTH CONTRIBUTION	GENERAL REGIMES	
		HEALTH CONTRIBUTION RATE	PENSION CONTRIBUTION RATE
Argentina	Social insurance	5%	27.0%
Bahamas	Social insurance	8.8%	
Barbados	Universal health insurance	1.0%	13.5%
Belize	Social insurance	7.0%	
Brazil	Social insurance	20%	
Chile	Mandatory private insurance	7%	21.9%
Colombia	Social insurance	12.5%	16.0%
Ecuador	General individual and family health insurance	5.2%	10.6%
Guyana	National Insurance Scheme; Social insurance	12.5%	
Jamaica	Social insurance and universal program	Not specified	6.0%
Panama	Social insurance	9%	13.5%
Suriname	Mandatory health insurance	Fixed amount (165 Surinamese dollars)	11.0%
Uruguay		Not specified	15.0%

Source: ISSA (2023) and national laws and regulations governing social security, as published by the respective ministries of labor and social security in each country.

Note: In Brazil, independent workers have options regarding their social security contributions, and the 20% rate is not mandatory for all. Independent workers can opt to contribute 20% of their chosen contribution base, which ranges from the minimum wage to the social security ceiling. Alternatively, they can choose to contribute 11% of the minimum wage, which excludes retirement by contribution time.

5.4 The Interaction between Taxes and Social Security

An often-overlooked but crucial issue is that the effective cost of formal labor in Latin America and the Caribbean can be shaped by special tax and social security regimes that vary according to firm size and are often directed to self-employed workers. Many countries in the region have adopted special regimes for small firms or self-employed workers with the intention of subsidizing low-income entrepreneurs, facilitating their inclusion in contributory programs, and easing compliance (Table 5.5). These regimes vary widely: in Argentina, for instance, self-employed workers face three distinct regimes ranging from heavily subsidized

single-payment schemes (Monotributo Social [Social Single Tax] and Monotributo [Single Tax]) to a higher-taxed general regime (Autónomo [Autonomous]). Brazil also has three distinct regimes for small firms and self-employed workers that define varying payroll and income taxes depending on sales levels.

As shown in Table 5.5, these regimes usually combine income and sales taxes into a single tax and, in some cases, subsidize the social protection contributions of business owners or their employees. By doing so, they can lower the barriers to formalization for microfirms and broaden the tax base. When subsidies are included, they can also expand social protection coverage among workers in small firms. However, there are at least two important drawbacks. First, subsidies can incentivize tax evasion, leading larger firms close to the regulatory threshold to underreport their true size or earnings in order to qualify for the simplified regime. Second, they can generate misallocation of resources across several margins, with negative implications for formal employment. For example, firms may reduce their size strategically to lower tax costs, resulting in smaller and less productive firms and, ultimately, less formal employment. Thus, more generally, these lower costs for small firms, which tend to be less productive, can be considered a subsidy for lower-productivity firms. They can also distort occupational decisions, with workers shifting to self-employment rather than wage jobs in order to benefit from preferential tax and social protection treatment (see the review by Azuara et al. 2019).

There is a rich literature examining these impacts. In Brazil, the introduction of the simplified tax regime Microempreendedor Individual [Individual Micro-Entrepreneur] (MEI) lowered the cost of firm formalization and increased formalization among previously informal entrepreneurs but did not lead to the creation of new formal firms or higher survival rates (Rocha, Ulyssea, and Rachter 2018). Because the MEI regime creates incentives for microfirms to reduce their size to qualify for the program, it induced distortions, and there is evidence of misallocation across occupations. Indeed, a descriptive analysis of administrative data suggests that a significant number of wage workers switched to self-employment strategically to benefit from the MEI (Azuara et al. 2019). Another example is Mexico's Régimen de Incorporación Fiscal [Fiscal Incorporation Regime] (RIF), introduced in 2014, which simplified tax obligations for microfirms and provided tax and social security discounts. A descriptive analysis of administrative records suggests that the number of businesses making mandatory social security contributions, which had remained constant since the early 2000s, increased substantially after the introduction of the RIF. Moreover, self-employed workers, who are not legally required to contribute, also began making more voluntary contributions. Although not causal, this evidence points to behavioral responses to the regime (Azuara et al. 2019). However, these effects were not large enough to generate a noticeable change in aggregate formality rates in Mexico (Azuara et al. 2019).

TABLE 5.5 SPECIAL TAX REGIMES IN SELECTED LAC COUNTRIES

COUNTRY	SPECIAL REGIME	INCOME TAXES	SALES TAXES	SOCIAL SECURITY TAXES OF OWNER	SOCIAL SECURITY TAXES OF EMPLOYEES	OTHER LABOR REGULATION
Argentina	Independent Worker Promoted (Régimen Trabajador Independiente Promovido)	✓	✓	✓		
Argentina	Single Tax (Monotributo)	✓	✓	✓		
Brazil	Individual Micro-Entrepreneur (Microempreendedor Individual)	✓	✓	✓		
Brazil	Single Tax (SIMPLES)	✓	✓	✓		
Colombia	Simple Alternative Minimum Tax (Impuesto Mínimo Alternativo Simple)	✓			✓	
Colombia	Simplified Value-Added Tax		✓		✓	
Costa Rica	Simplified Regime (Régimen Simplificado)	✓	✓			
Ecuador	Simplified Tax Regime (Régimen Impositivo Simplificado)	✓	✓	✓		
Mexico	Fiscal Incorporation Regime (Régimen de Incorporación Fiscal)	✓	✓	✓	✓	
Peru	Single Simplified Regime (Régimen Único Simplificado)	✓	✓			
Peru	Special Regime for Income Tax (Régimen Especial de Renta)	✓				
Peru	Special Labor Regime (Régimen Especial Laboral)					✓
Uruguay	Single Tax (Monotributo)	✓	✓	✓		
Uruguay	Social Single Tax (Monotributo Social MIDES)	✓	✓	✓		
Uruguay	Literal E (special VAT regime)	✓	✓			

Source: Azuara et al. (2019).

Note: Special tax policies available to large formal firms also cause distortions. In Colombia, for example, large firms can deduct all labor costs, including wages, social security contributions, and all payroll taxes, from their profit tax base. As a result, the relative cost of hiring a formal worker compared with an informal worker drops to just 4.7 percent. By contrast, smaller firms, which are exempt from profit taxes, must bear the full cost of social security contributions, making the relative cost of hiring a formal worker 47 percent, that is, 10 times higher (Fernández Mejía 2025). Thus, tax deduction benefits significantly lower the marginal relative cost of hiring formal workers for large firms compared with smaller, tax-exempt firms.

Together, these policies—tax advantages for large firms and special regimes for small firms and the self-employed—can generate complex distortions that affect formal employment. While these policies are well-intentioned, seeking to encourage formality among the self-

employed and small businesses, they can have unintended negative effects, as evidence from LAC shows. In Peru, the fact that firm size tends to cluster around the eligibility thresholds of special regimes in the tax codes suggests that they can deliberately limit formal employment to preserve tax benefits. In Brazil, the introduction of a special regime for the self-employed appears to have prompted wage workers to reclassify themselves as entrepreneurs. In Colombia, the waiver of income tax for small firms and the labor cost deductions from the income tax increase the share of small firms hiring workers without a formal contract (Azuara et al. 2019; Fernández Mejía 2025).

Beyond their effects on formal employment, these policies can also undermine productivity. Recent evidence from the Dominican Republic shows that firms operating under special regimes exhibit lower total factor productivity yet survive longer thanks to reduced tax burdens. In fact, one peso of capital and labor invested in firms under the general regime is 43 percent more productive than one peso of capital and labor invested in firms benefiting from special regimes (Azuerio et al. 2019).

This dynamic between corporate taxes and social security costs helps explain why labor informality is often more prevalent in small formal firms than in large ones. Fernández Mejía (2022) finds that, in small firms, workers are frequently hired informally and even illegally, without social security, and that 51.9 percent of small firms in Latin America and the Caribbean hire workers earning below the minimum wage, compared with just 8.0 percent of large firms. These findings point to a broader lesson: policies that seek to reduce the costs of formalization for small firms and the self-employed—even when successful in increasing formalization by lowering immediate compliance costs—may inadvertently depress productivity, either by encouraging the entry of too many unproductive firms or by incentivizing firms that have the potential to grow to stay small. Recognizing and addressing these trade-offs is essential and is taken up explicitly in Chapter 7.

Regimes designed to ease formalization for small firms can backfire, leading to too many small and unproductive firms.

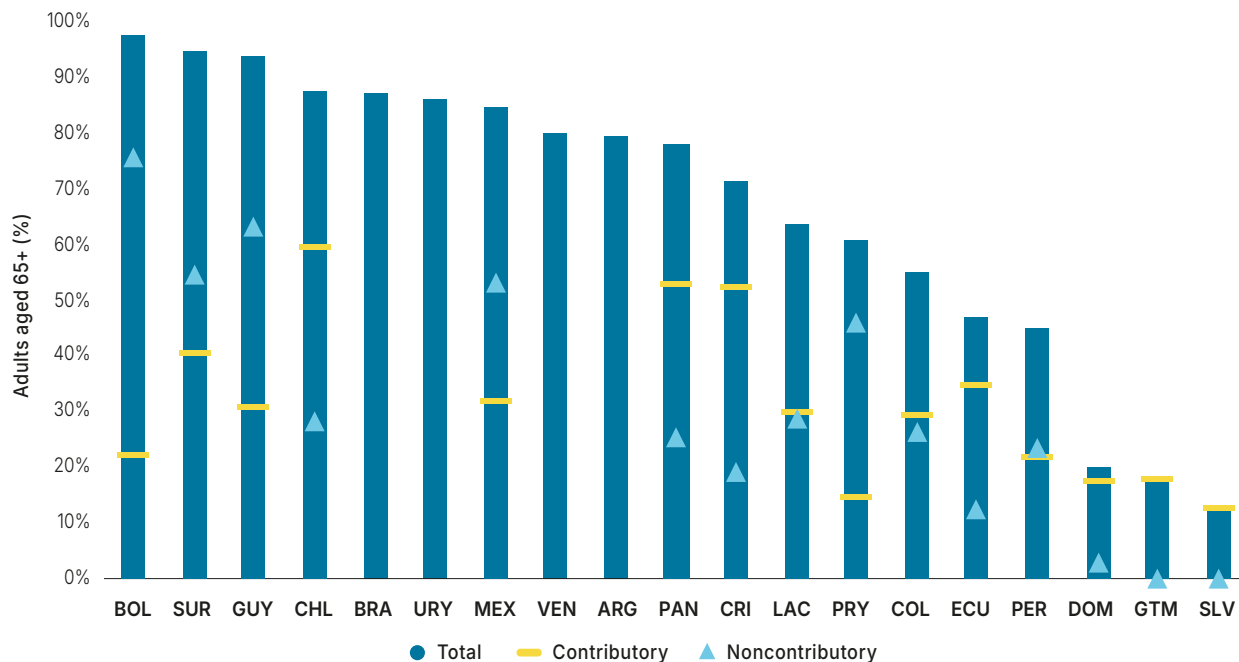
5.5 The Limits of Employment-Based Pension Systems

In Latin America and the Caribbean, approximately 60 percent of individuals over age 65 receive either a contributory or a noncontributory pension, a figure only slightly below the global average (Figure 2.13). This figure represents a significant increase from 34 percent two decades ago. However, most of this expansion has been driven by the growth of noncontributory pension programs aimed primarily at preventing old-age poverty (Aranco et al. 2022). Noncontributory pensions have become a fundamental source of coverage in the region: of the 60 percent of older adults receiving a pension, only about 32.5 percent receive a contributory benefit, while the remaining 27.6 percent rely on noncontributory schemes. In countries such as Bolivia, Guyana, Mexico, and Suriname, noncontributory pensions constitute the main source of old-age income support. By contrast, contributory pension coverage remains low in most countries, with notable exceptions such as Chile, Panama, and Costa Rica (Figure 5.2).

Around 60 percent of older adults in the region now receive a pension—but most of the expansion of coverage came from noncontributory programs, not from contributory coverage.

Limited access to formal salaried employment leads many individuals to never contribute to pension systems. Others contribute intermittently and fail to qualify for contributory pensions due to low contribution densities; that is, although they participate in the system at some point, they contribute only for a small share of their working lives. Low contribution densities typically indicate that an individual will fall short of the required eligibility criteria. Indeed, most countries in the region set minimum contribution requirements for pension eligibility. In Argentina and Ecuador, for example, workers must contribute for at least 25 years, while, in most other countries, the threshold is 15 or 20 years. Caribbean nations, including The Bahamas, Barbados, and Trinidad and Tobago, have lower requirements, typically 10 years. For this reason, Chapter 8 examines options such as eliminating vesting-period requirements, providing proportional contributory pensions to individuals with low contribution densities, and integrating these benefits into the universal noncontributory pension.

FIGURE 5.2 SHARE OF ADULTS AGED 65+ WITH CONTRIBUTORY AND NONCONTRIBUTORY PENSIONS, 2023



Source: Authors' calculations using data from IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.
Note: It is not possible to distinguish between contributory and noncontributory coverage in Uruguay, Venezuela, Argentina, or Brazil. Chile's noncontributory coverage may include workers with low contributory pensions, unlike the rest of the countries. The Dominican Republic offers noncontributory coverage only for a vulnerable subset of the overall population.

In many countries, ensuring the financial sustainability of contributory pension systems remains a major challenge. Most contributory pensions in the region operate under DB plans, in which pension amounts are determined based on a worker's contribution history. While financial unsustainability is not inherent in DB plans, they often face significant financial imbalances because of parameters that imply a large gap between contribution income and benefit payments. As populations age, these imbalances are expected to grow unless reforms adjust pension levels and contribution parameters. Without such adjustments, the share of GDP allocated to pension expenditures could increase two- to threefold (Aranco et al. 2022).

By contrast, DC plans determine pension levels based on the assets accumulated over a worker's lifetime. Since benefits are directly tied to contributions, and each individual's pension is essentially prefinanced, these systems are less likely to experience financial shortfalls. However, they frequently present challenges when it comes to ensuring pension adequacy, as benefits are often lower than expected by retirees. For example, in Chile, Peru,

and Bolivia, pension payments under DC systems amount to less than 30 percent of average wages (Aranco et al. 2022). While low payouts are not inherent in DC schemes (adequate pensions are possible with higher contributions or investment returns), the DC systems observed in the region generally provide pensions that are low relative to workers' wages and expectations.

Given the challenges of sustainability and adequacy, pension reform proposals in the region frequently consider adjustments to employer and employee contribution rates. The goal of these adjustments is to increase contribution levels to ensure sufficient funding for promised benefits or, in the case of DC schemes, to increase pension amounts. This approach is evident in recent reform proposals presented to national legislatures in Panama, Chile, The Bahamas, and Barbados. In fact, in the English-speaking Caribbean, independent actuarial reviews commissioned by governments generally recommend raising contribution rates (González-Velosa, Villa, and García-Huitrón 2026).

While increasing contribution rates can improve financial sustainability or adequacy, doing so does not address the fundamental issue of the lack of coverage for workers with sporadic participation in the labor market, who are usually the most vulnerable. Moreover, in countries in which pension contribution rates are already high—such as Brazil, where the statutory rate stands at 29 percent for a worker earning the average wage—there is limited room for further increases, which could reduce formality and coverage by making the hiring of formal workers prohibitively expensive.

Therefore, it is crucial to explore alternatives that ensure the sustainability and adequacy of pension systems without generating unintended labor market distortions. One option discussed in Chapter 8 is integrating a universal noncontributory pillar into the system, which could allow for income up to a certain threshold to be exempted from pension contributions (Ripani et al. 2023). This approach could help reduce nonwage labor costs and encourage formal employment, particularly among low-income workers who have the highest rates of informality. Additionally, adjusting vesting requirements could expand coverage for workers with low or irregular contribution histories. Eliminating strict vesting periods would allow these workers to receive proportional contributory pensions—whether small or large—based on their accumulated contributions, which could then be supplemented by a universal noncontributory pension.

5.6 The Missing Piece: Unemployment Insurance

Unlike pension programs, unemployment insurance programs are rarely part of social security systems in the region. Instead, most Latin American and Caribbean countries provide income protection to unemployed workers through severance payments, which can serve as a useful mechanism to protect the income of workers who lose their jobs, by providing a lump-sum payment to terminated employees based on their earnings and length of service. However, from their inception, the primary goal of severance payments has not been income protection for the unemployed but, rather, protecting jobs by increasing the costs for firms when dismissing workers. In fact, as described in Chapter 4, severance payments are regulated by labor laws rather than social security legislation. They were introduced in Latin American countries in the early twentieth century⁴² as part of a wave of job-protection legislation, even before the establishment of old-age pensions and social insurance schemes (Holzmann et al. 2011).

By contrast, in high-income OECD countries, although severance payments exist, unemployment insurance is the primary form of income support for unemployed workers. Thirty-two of the 34 non-LAC OECD countries have an unemployment insurance system, the exceptions being Australia and New Zealand.⁴³ Under this arrangement, benefits are collectively financed through employer and employee contributions, and, consistent with social security principles, risk pooling is ensured. Benefit levels may be linked to previous earnings or set as fixed amounts and are offered for a maximum duration unrelated to tenure. Workers are eligible if they have contributed sufficiently and have been involuntarily terminated. Eligibility often requires participation in active labor market policies, such as employment services and training through public employment services. Tax revenues are sometimes used as a funding source, either as the primary mechanism, as in Australia, or as a complementary one. In addition, several OECD countries provide means-tested unemployment assistance for individuals requiring supplementary support, as in Finland and Germany (OECD 2023).

42. The first severance pay legislation was enacted in Mexico (1917) and was soon followed by Bolivia (1924 and 1925), Chile (1924), Peru (1924, 1925, 1930), Argentina (1930), Colombia (1934), El Salvador (1935), Venezuela (1936), and Uruguay (1944) (Holzmann et al. 2011).

43. Unemployment insurance is typically based on previous earnings and requires a work history or social contribution payments. By contrast, unemployment assistance is means-tested and either provides a safety net for those who have exhausted unemployment insurance benefits or supports job seekers who are not eligible for unemployment insurance. This definition served to calculate the proportion of OECD countries with unemployment insurance.

Alongside severance payments and unemployment insurance, a third mechanism for securing income after job loss is the individual savings account. Under this arrangement, benefits are typically financed through employer contributions and accumulated in individual accounts. Workers can access these funds, along with any returns on their investment, when they become unemployed.

Although individual savings accounts are less common than severance payments, they have been adopted in several Latin American countries, including Chile, Colombia, Costa Rica, Ecuador, Peru, and, most recently, Honduras (Table 5.6). The individual-account contribution rate is typically 8–10 percent of wages (Colombia, Ecuador, Peru, and Brazil), with lower rates in Costa Rica (1.5 percent) and Panama (1.9 percent). In fact, LAC has a relatively high prevalence of individual savings accounts compared with other regions globally (World Bank 2022). In principle, these schemes offer operational advantages over traditional unemployment insurance since they require less administrative capacity to verify eligibility conditions. Another potential advantage of individual savings accounts is that they are less likely than unemployment insurance to create moral hazard. Since workers rely on their accumulated savings during periods of unemployment, there is no financial incentive to remain unemployed longer than necessary since doing so would deplete their personal funds. By contrast, traditional unemployment insurance, which pools resources and is funded collectively, often through employer and government contributions, can sometimes reduce the urgency for job seekers to return to work since benefits are received regardless of individual savings or past behavior.

TABLE 5.6 INSTRUMENTS TO HANDLE UNEMPLOYMENT RISK IN LAC, CIRCA 2023

SUBREGION	COUNTRY	UNEMPLOYMENT INSURANCE	INDIVIDUAL ACCOUNTS	END-OF-SERVICE COMPENSATION OR SEVERANCE PAYMENT
Andean	Bolivia			✓
	Colombia	✓	✓	✓
	Ecuador	✓	✓	✓
	Peru		✓	✓
	Venezuela	✓		Not allowed
Southern Cone	Brazil	✓	✓	✓
	Argentina	✓		✓
	Uruguay	✓		✓
	Paraguay			✓
	Chile	✓	✓	✓
Central America	Belize			✓
	Costa Rica		✓	✓
	Dominican Republic			✓
	El Salvador			✓
	Guatemala			✓
	Honduras		✓	✓
	Mexico			✓
	Panama		✓	✓
Caribbean	The Bahamas	✓		✓
	Grenada	✓		✓
	Barbados	✓		
	Antigua and Barbuda			✓
	Dominica			✓
	Guyana			✓
	Jamaica	Introduction currently underway		✓
	Saint Vincent and the Grenadines			✓
	Suriname			✓
	Trinidad and Tobago			✓
	Haiti	None		

Source: For Central American, Andean, and Southern Cone countries, this information was sourced directly from national laws and regulations governing social security published by the respective ministries of labor and social security in each country. The information for Caribbean countries was sourced from the International Labour Organization (ILO) World Social Protection Database.

Note: In Venezuela, since 2002, annual presidential decrees have granted inamovilidad laboral [job stability] to most public and private employees, protecting them from dismissal or transfer without a just cause approved by the labor inspector. Workers with less than one year of tenure, a management position, or seasonal or occasional employment are excluded. In Panama, all companies are required to establish a severance fund and make the respective quarterly deposits or contributions through a trust.

Severance payments, individual savings accounts, and unemployment benefits depend on job formalization, which, as discussed in Chapter 2, is limited to only half of the working population in Latin America and the Caribbean. However, these mechanisms are not available even to all formal workers since, in most countries, eligibility depends on the type of labor contract. Additionally, these mechanisms require minimum contribution densities that workers often fail to meet, and, as a result, take-up is low (Asenjo and Pignatti 2019). For instance, comparisons across countries with available data show very limited coverage overall. Even in the best-performing case, Uruguay, benefits reach at most 5 percent of the unemployed population, while coverage in Colombia and Argentina is only about 1 percent (Figure 5.3).

FIGURE 5.3 UNEMPLOYMENT INSURANCE: ELIGIBILITY REQUIREMENTS AND COVERAGE, 2024



Source: Panel A: Chile's Seguro de Cesantía (Ley N° 19.728) and World Bank. Panel B: Authors' calculations based on data from IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The data for Chile include unemployment insurance and severance pay.

The limited coverage of unemployment insurance is particularly concerning because it leaves severance pay and individual accounts as the primary mechanisms for income protection during unemployment, both of which have significant drawbacks. For instance, even workers who have access to severance payments may still face inadequate protection since these payments provide less effective income security than unemployment benefits. Unlike unemployment insurance, which provides periodic payments over a defined period and helps workers smooth consumption during job loss, severance pay offers only a one-time lump sum

based on employment history. Additionally, severance pay offers more limited coverage, as it generally applies only to specific circumstances, such as layoffs, and does not cover all types of job separations, thus leaving some workers without support. Lastly, severance payments are often delayed, arriving too late to support workers during unemployment.

There is also a significant risk of noncompliance in severance payments. In the absence of mandatory funding provisions for severance liabilities, firms may lack the liquidity to meet their obligations, potentially accelerating business closures and making enforcement both uncertain and litigious. In some cases, workers may not even be aware of their entitlements.

For instance, in the Dominican Republic, roughly half of workers employed under open-ended contracts who are dismissed without cause are entitled to receive Auxilio por Cesantía [severance pay]. However, in 2024, only 52 percent of those legally entitled to it received it, and 7 percent were disputing it, with legal fees consuming, on average, 33 percent of the total benefit. The high cost of legal services reflects broader weaknesses in the dispute-resolution system. Disputes over severance payments are common and frequently lead to litigation. These judicial processes are often lengthy: the average case lasts around 16 months, and the issuance of court rulings averages 5.5 months. Approximately 50 percent of these rulings are ultimately in favor of the worker (Velásquez Pinto 2016).

Individual savings accounts also have notable drawbacks compared with unemployment benefits. Like severance payments, they are easier to administer but lack a risk-pooling mechanism across individuals, making them a form of forced saving rather than true insurance. These accounts provide limited protection, particularly for workers with low saving capacities, who tend to be the most vulnerable to job loss. Moreover, they are frequently treated as general-purpose savings rather than dedicated income protection, with legislation often allowing their use for expenses such as housing or education. This flexibility has diluted their intended role as a safeguard against income loss during unemployment. For example, in Colombia, only 35 percent of individual account savings are used as income protection following job termination, while the majority—54 percent—is spent on housing, and the remainder on education (González-Velosa 2021). Because they lack collective financing, risk pooling, and solidarity, individual savings accounts do not meet the ILO's social security standards (Vandaele, Piasna, and Zwysen 2024).

Thus, unemployment insurance clearly offers several important advantages. By linking benefits to prior earnings, it improves consumption smoothing. It can also be adjusted over the business cycle, with the extension of coverage during downturns. Moreover, as discussed later, unemployment insurance can be integrated into active labor market policies to combine income support with services that help job seekers return to work quickly and effectively.

However, there have been few meaningful reforms expanding unemployment protection in the region. Jamaica is currently in the process of introducing an unemployment insurance scheme. Colombia launched the *Mecanismo de Protección al Cesante* [Unemployed Person Protection Mechanism] in 2013, which includes promising features such as the integration of passive and active labor market policies. Similarly, in 2016, Ecuador introduced its *Seguro de Desempleo* [Unemployment Insurance], transforming its individual severance savings scheme into a mixed system that combines unemployment insurance with individual accounts. Nevertheless, as shown in Figure 5.3, coverage remains limited in both Ecuador and Colombia, and, as shown in Table 5.6, the new systems continue to coexist in a fragmented manner with traditional severance pay arrangements.

To sum up, protection against unemployment risk in the region remains very limited. This shortfall not only weakens protection against unemployment shocks but also has spillover effects on old-age security. As discussed in more detail in Box 5.1, in the absence of adequate unemployment insurance, many countries with DC individual account systems have relied on pension withdrawals as an imperfect substitute. This practice has depleted retirement savings and may undermine the pension system's ability to provide adequate income in old age.

**BOX 5.1 WEAK UNEMPLOYMENT INSURANCE CAN UNDERMINE
LONG-TERM PENSION ADEQUACY**

In Latin America and the Caribbean, very few households have sufficient precautionary savings to smooth consumption during periods of income loss. In countries with DC individual account systems, pension funds often represent the only significant form of savings for many workers. Although these mandatory savings are intended to be illiquid and preserved until retirement, access to both compulsory and voluntary pension funds is common in practice (Bosch et al. 2020).

In the absence of adequate unemployment protection, many countries with DC individual account systems resorted to extraordinary pension withdrawals during the COVID-19 pandemic to cushion income shocks. These measures provided short-term relief but carried severe long-term consequences for retirement security. In Peru, workers are estimated to have lost around 40 percent of their pension balances, with the largest losses concentrated among low-income and older contributors—the groups least able to rebuild their savings. In Chile, total pension assets fell from 82 to 60 percent of GDP, the poorest affiliates lost up to 60 percent of their retirement savings, and 32 percent of individual accounts were emptied (Izquierdo, Robles, and Tapia 2024). These experiences illustrate how inadequate unemployment support can undermine the fundamental goal of ensuring adequate pensions. Several other countries in the region, including Panama, El Salvador, and the Dominican Republic, approved similar withdrawal schemes during the pandemic.

Some countries also permit regular, nonemergency withdrawals from pension accounts in cases of unemployment that can further erode long-term retirement savings. In Mexico, for example, workers are allowed to withdraw funds for unemployment under normal circumstances—this mechanism is permanent and not tied to extraordinary events such as the COVID-19 pandemic. In 2023 alone, 1.77 million workers, around 8 percent of formal workers, accessed resources from their pension accounts through this channel. Workers may withdraw part of their individual pension balance beginning on the 46th day of unemployment, provided that they meet specific requirements, such as having held an account for at least three years, having contributed for at least two years to the *Instituto Mexicano del Seguro Social* [Social Security Institute], and not having made a similar withdrawal within the previous five years. Although these withdrawals are tax-exempt, they reduce the number of contributed weeks, potentially affecting a worker's eligibility for the minimum guaranteed pension.

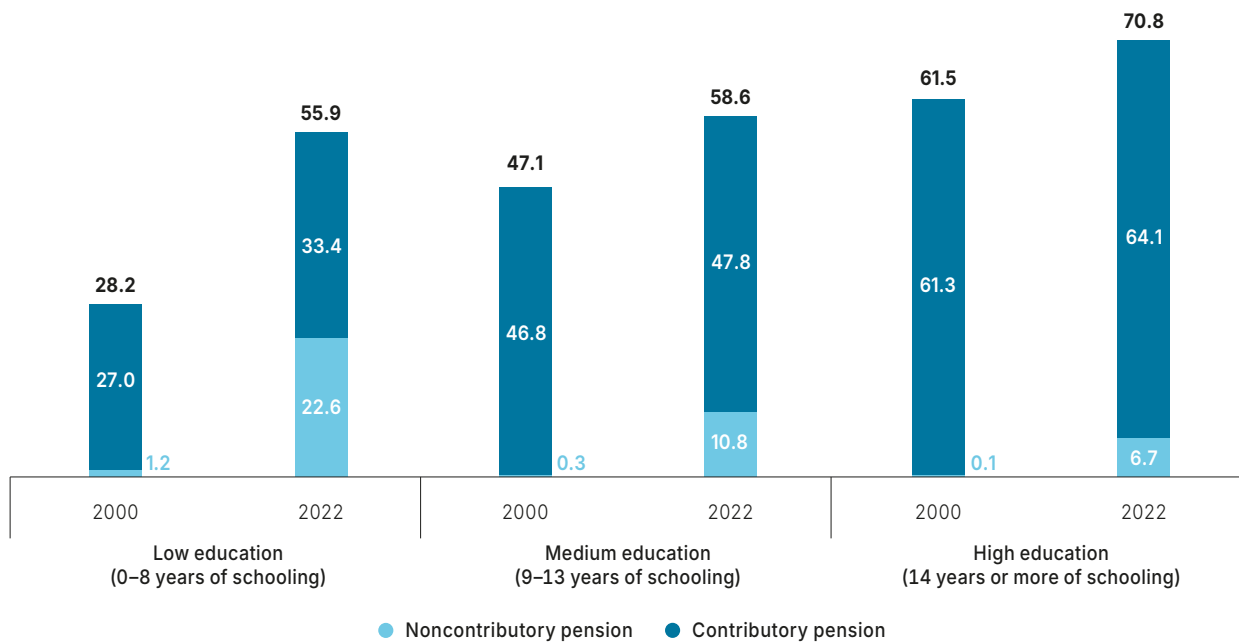
In sum, the region's limited unemployment protection exposes workers to income shocks that are often absorbed through pension withdrawals—an approach that provides short-term relief at the cost of long-term pension adequacy. Strengthening unemployment insurance and automatic stabilizers is essential to safeguard both worker well-being today and retirement security tomorrow.

5.7 Filling the Gaps in Social Protection: The Role of Noncontributory Social Assistance Programs

As seen above, given the high prevalence of informal labor, Bismarckian social security schemes have not been able to ensure adequate coverage or protection. In response, many countries in the region have introduced noncontributory programs and safety nets to reach those outside the contributory system, such as informal salaried workers and the self-employed (Palacios and Robalino 2020).

For example, as discussed earlier, the number of countries offering social pensions financed through general revenues has expanded substantially in recent years, and coverage from noncontributory pensions has increased rapidly. This expansion has been most prevalent among the most disadvantaged groups, which typically lack access. The population of elderly people with low levels of education almost doubled its coverage rate between 2000 and 2022, from 28 to 55.9 percent, and more than half of this increase was associated with access to noncontributory pensions (Figure 5.4).

FIGURE 5.4 EVOLUTION OF PENSION COVERAGE IN THE ELDERLY POPULATION, LAC-16



Source: Authors' calculations using IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

With weak unemployment insurance, workers sometimes cushion job loss by draining their pensions—short-term relief bought at the cost of old-age security.

These programs have significantly reduced gaps in health and pension coverage. This expansion is crucial because, even in the region's best-performing countries, such as The Bahamas, Chile, and Uruguay, a considerable share of older adults will still not qualify for a contributory pension (Aranco et al. 2022). While some countries, such as Guyana and Bolivia, offer universal social pensions, most rely on targeted schemes based on means or income tests to provide at least some protection to lower-income informal workers.

However, important challenges remain. The expansion of noncontributory programs is often disconnected from the contributory system, resulting in a complex and fragmented social protection architecture that often lacks coordination. In fact, it is often the case that noncontributory pillars and contributory pillars are administered by different government agencies. This fragmentation generates several risks. First, it can weaken the incentives to contribute to mandatory insurance programs and to formalize employment, particularly when noncontributory benefits are close in value to those offered through contributory schemes. This is, for instance, the case of the pension system in Brazil, where the noncontributory pension (Rural/Benefício de Prestação Continuada [Continuous Cash Benefit]) is equal to the minimum contributory pension (Bosch, Melguizo, and Pagés 2013). A similar case can be seen in Argentina, where multiple “moratoriums” during which people can make up for missing contributions at an extremely low cost have, in practice, provided essentially noncontributory pensions similar to contributory pensions (Bosch and Guajardo 2012). Although the first moratorium was considered a temporary stopgap measure when it was implemented from 2005 to 2006, the most recent extension was passed in 2023.

Second, because contributory programs embed redistributive arrangements that are not aligned with noncontributory schemes or with the system, the overall distributional outcome can be regressive. In Colombia, for example, the pension system is highly regressive: the subsidies for contributory pensions received by formal workers are substantially larger than those allocated to the antipoverty social pension that targets the most vulnerable (Becerra, García-Huitrón, and González-Velosa 2022).

Lastly, important statutory coverage gaps may arise, particularly among informal workers in the middle of the income distribution. These workers often fall into a legal void: they are not poor enough to meet the legally defined eligibility criteria for social assistance, yet they are

not sufficiently formal to acquire the legal entitlement required for contributory insurance. As a result, they are legally excluded from both sides of the system—neither mandated nor eligible to participate in contributory schemes, nor entitled by law to receive noncontributory benefits—leaving them without statutory protection (Palacios and Robalino 2020).

Thus, as noted earlier and discussed further in Chapter 8, it is essential to integrate contributory insurance and redistributive transfers within a unified social protection system. Such integration can expand coverage and improve equity while reducing labor market distortions. Despite current challenges, a feasible path exists toward a less fragmented system that provides universal protection and strengthens incentives for formal and productive employment.



6



Skills Development and Employment Policies for the Workforce



THIS CHAPTER IN **FIVE** POINTS

1 Skills mismatches are widespread by global standards and driven by structural gaps. In countries with available data, more than 40 percent of workers are in jobs that do not align well with their skills, mostly due to deficits in numeracy and literacy skills. Moreover, more than half of workers are employed in occupations unrelated to their field of study. Such mismatches are much more widespread in Latin America and the Caribbean than in advanced economies.

2 Technical and vocational education and training (TVET) systems have significant potential but remain limited in scale and accountability. TVET systems can play a key role in aligning the supply of skills with private sector needs and in including individuals with limited academic pathways. While provision has diversified—spanning a wide range of providers and delivery models—progress in the region has been slow and limited in scale by international standards, with few exceptions. Public

spending is still largely channeled through supply-side subsidies that are not linked to performance or outcomes. Accountability and quality assurance are weak, and systematic tracking of results remains rare.

3 Skills development during working lives is insufficient. Skill accumulation after entry into the labor market is limited. Workers with 25 years of experience see cumulative wage gains of about 85 percent in advanced economies, compared with only 35 percent in Latin America and the Caribbean, suggesting weaker human capital accumulation in the region. Investment in adult training is also low, pointing to a near interruption of skills development after formal schooling.

4 Active labor market policies are widely used social policies with potential impact but face significant implementation challenges. These programs have strong political appeal and have expanded in recent years. A large body of evidence shows that they can have positive impacts on labor market outcomes and be cost-effective. However, in practice they are often fragmented and weakly linked to social protection systems. Many programs operate in isolation, and financing mechanisms provide little incentive to prioritize employment outcomes.

5 Policy design matters: better information, incentives, and employer engagement can improve outcomes. Evidence shows that active labor market policies are more effective when they align training with labor demand, strengthen skill signaling, incorporate work-based learning, and use results-based incentives—highlighting clear pathways for reform.

6.1 When Skills and Jobs Fail to Meet

In this chapter, we examine policies that aim to improve workers' prospects by expanding access to skills development and improving how job seekers are matched to available jobs. When well designed, these policies can be powerful tools for raising productivity and promoting equity.

These policies are mainly justified by well-known problems in how skills are developed and how labor markets function. As discussed in Chapter 3, many workers face financial constraints that prevent them from investing in education or training, even when these investments would pay off over their working lives. Gaps in information also matter: training providers may struggle to keep programs aligned with changing labor market needs, and job seekers often lack clear information about available jobs where their skills would be best used.

Firms also face challenges. They may hesitate to invest in broadly useful skills because trained workers can leave for other employers, making it hard to recover those costs. They also often struggle to find suitable workers and to set wages at the time of hiring, while workers have limited information about their options and about how to signal their skills when looking for a job. Together, these factors lead to too little investment in skills and to job matches that fall short of workers' and firms' productive potential.

The chapter is organized as follows. First, we review evidence on skills mismatches in the labor market in Latin America and the Caribbean, specifying different typologies and their underlying causes. In addition, we present new calculations using data from the Programme for the International Assessment of Adult Competencies (PIAAC).

Second, we analyze policies and institutions aimed at equipping workers with the skills demanded by the labor market, often through the regulation of private training providers or the direct public financing of training programs. We recognize that the skills demanded in the labor market are diverse, including foundational, digital, and specialized technical skills. We also acknowledge that skill formation is a cumulative process that occurs throughout the life cycle, from early childhood to adulthood, and through a variety of modalities, including formal schooling and practical on-the-job learning. However, this chapter does not cover all aspects of skill formation. Instead, we focus on technical and vocational education and training (TVET), which equips individuals with the practical knowledge and competencies needed for specific trades and occupations. TVET is a core labor institution, particularly important in the context of an aging workforce and rapid technological change, which require constant reskilling amid ongoing disruptions to productive activities.

Third, we examine active labor market policies (ALMPs), which comprise interventions designed to support job search, facilitate job matching, and promote transitions into employment or between jobs. These policies encompass services such as intermediation, job placement assistance, training linked to employment, certification, and wage subsidies.

Together, TVET and ALMPs constitute core labor market institutions, alongside labor regulation and income protection, that shape employability, productivity, and workers' ability to adapt to economic change. While some interventions, most notably training, appear in both domains, they are analytically distinct. In the context of TVET, training is part of a system of human capital accumulation. In the context of ALMPs, it is primarily an instrument to facilitate job placement. Accordingly, we analyze each set of policies separately in the sections that follow.

6.2 A Region with Prevalent Skills Mismatches

Skills mismatches in the labor market, which in this book we define as a broad range of imbalances between the supply of and demand for skills, can arise from a wide range of causes. For instance, mismatches may arise when individuals make educational and career decisions based on incomplete information about the economic returns of each option. They can also stem from the fact that wages sometimes serve as “noisy signals” that do not accurately reflect the true demand for skills, or from an inelastic supply of skills training that can arise if entry barriers or regulations constrain education provision. Inefficient hiring practices by employers, or labor regulations that hinder recruitment, are also examples of possible causes of skills mismatches.

Given the inherent frictions in labor markets, a certain degree of skills mismatch is expected and may even be a positive signal of a dynamic economy. However, when these mismatches are both extensive and persistent, they can lead to significant social and economic costs.

Concerns about skills mismatches have intensified in recent years, since they may be driven by global trends such as technological change and climate change. Skills obsolescence can have profound social impacts, for example, when automation displaces large communities of workers who are then unable to relocate due to a lack of adequate skills. Additionally, climate policies can impose significant social costs if they lead to the displacement of workers from high-carbon sectors. Furthermore, shortages in essential skills may hamper the effective implementation of both technological and climate change initiatives.

Measuring the extent and nature of skills mismatches remains challenging. As discussed in Box 6.1, mismatches can be defined at both the individual and aggregate levels and may refer to gaps in competencies or in formal qualifications. Distinguishing among these concepts is important because they imply different policy responses.

Estimates of skills mismatches are well documented in advanced economies, but comparable evidence for Latin America has become available only recently, largely due to improvements in data availability. A key source is the OECD's PIAAC, which provides harmonized measures of adult skills. PIAAC data are currently available for four Latin American countries: Chile, Ecuador, Mexico, and Peru.

Using these data, recent studies estimate occupational underskilling and overskilling at the individual level, defined as the extent to which workers' skill levels are above or below those required in their current jobs. Two main methodological approaches are used. The first relies on subjective measures, based on workers' self-reported assessments of whether they are under- or overskilled for their jobs. The second uses more objective measures, which compare workers' skill levels—measured through standardized assessments—to the mean or modal levels observed among peers in the same occupation, or to benchmarks defined by professional job analysts.

For instance, using PIAAC data, Castro et al. (2022) find that the incidence of overskilling is substantial in Chile, Ecuador, Mexico, and Peru, although with considerable cross-country variation. Whereas objective measures of overskilling in numeracy and literacy are around 20 percent in Chile, Ecuador, and Peru, they are close to one-third in Mexico. Subjective measures yield estimates of the same order of magnitude as objective measures. And, generally, they are significantly lower than those typically observed in OECD countries, where overskilling—particularly in numeracy—can reach up to 60 percent using either objective or subjective measures. An OECD-based analysis, however, reports different patterns. Analyses using alternative methodologies find that Latin American countries stand out for having rates of overskilling in numeracy that are well above the OECD average (OECD 2019). These discrepancies likely reflect methodological differences in how skill requirements are defined and how mismatches are measured.

We conduct our own analysis using PIAAC data to assess the extent and labor market implications of skills mismatches across 28 countries, four of which—Chile, Ecuador, Mexico, and Peru—are in Latin America and the Caribbean. We follow the methodology proposed by Bandiera et al. (2024) to estimate the prevalence of skills mismatches by characterizing the distribution of employed individuals according to the quality of the match between their

skills and the skills that their occupation requires. It is important to emphasize that this is an approach to measuring skills, rather than degrees, understanding that both skills and degrees affect individuals' wages (Busso, Montaña, and Muñoz 2020).

The analysis combines results from the PIAAC skills assessments with an estimation of job skill requirements. Rather than relying on externally defined benchmarks for job requirements, we construct a task-based index of skill requirements derived from the difficulty-weighted tasks that workers report performing on the job. This index is ranked within each country and used to assign both workers and occupations to skill quintiles, allowing us to measure population shares across different degrees of match. A perfect match is defined as one in which a worker's skill assessment ranking falls within the same quintile as the skill requirements of their occupation. A good match occurs when the worker's ranking is within one quintile of the occupation's ranking, while a poor match corresponds to a gap of two or more quintiles in either numeracy or literacy. By constructing a task-based index of job skill requirements, our approach differs from Castro et al. (2022) and OECD (2019), who rely on peer-based benchmarks. We also deviate from these studies by capturing the full spectrum of over- and underskilling across both numeracy and literacy.

Using this methodology, we find that, on average, about 15 percent of workers in the sampled Latin American and Caribbean countries exhibit a perfect skills match relative to their occupations' requirements, while roughly 45 percent can be classified as good matches (Table 6.1). More than 40 percent of employed workers are poorly matched to their jobs, reflecting either overskilling or underskilling relative to occupational skill demands.⁴⁴

More than 40 percent of workers in the region are poorly matched to their jobs—and nearly 70 percent of those poor matches reflect workers who lack the foundational skills their jobs require.

44. Part of this mismatch occurs because of natural variation in scores (Brun-Schammé and Rey 2021). In any random distribution, some individuals will naturally fall above or below a specific cutoff due to measurement error or individual variation. This is why we focus only on the proportion and direction of poor matches, ignoring workers who may not perfectly match their job requirements but are otherwise relatively good matches.

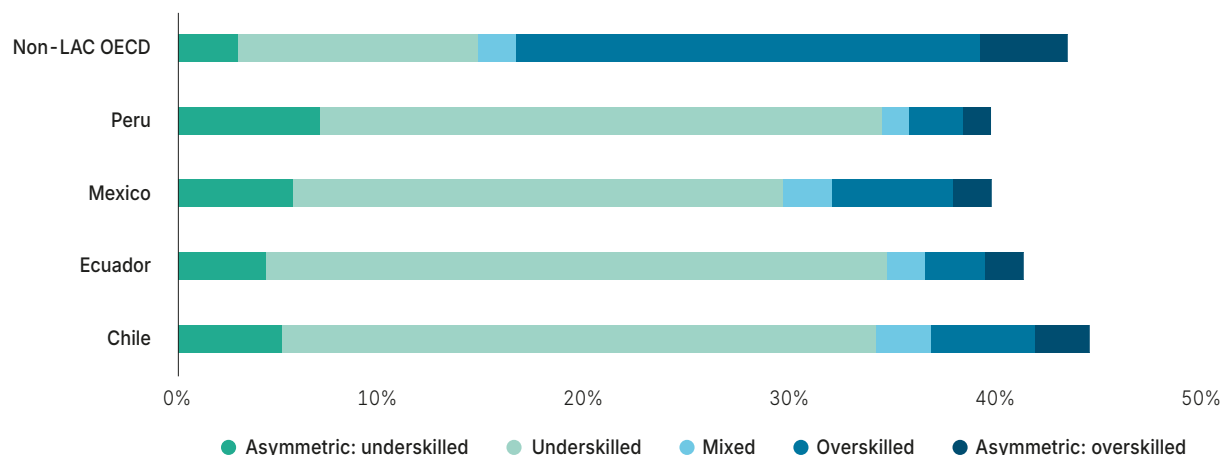
TABLE 6.1 SKILLS MISMATCH USING PIAAC DATA

COUNTRY	PERFECT	GOOD	POOR
Chile	14.8%	39.6%	45.6%
Ecuador	16.5%	42.8%	40.7%
Mexico	11.4%	49.1%	39.5%
Peru	13.5%	46.8%	39.7%
Rest of the sample	14.1%	44.2%	41.7%

Source: Authors' calculations using PIAAC data for 2018 and following the methodology outlined by Bandiera et al. (2024).

We further disaggregate poor matches into five categories: (i) underskilled workers, whose numeracy and literacy skills fall below occupational requirements; (ii) mixed mismatches, where workers are underskilled in one dimension—numeracy or literacy—and overskilled in the other; (iii) overskilled workers, whose skills exceed occupational requirements in both dimensions; and (iv) asymmetric mismatches, in which workers are over- or underskilled in one dimension while well matched in the other. As shown in Figure 6.1, poor matches are largely driven by workers who fall behind in both literacy and numeracy relative to the task-based index of job requirements. Across the four Latin American countries, nearly 70 percent of poor matches are attributable to underskilled workers. In contrast, in non-LAC OECD countries, poor matches are mostly explained by overskilling.

FIGURE 6.1 WORKERS BY TYPE OF MISMATCH



Source: Authors' calculations using PIAAC data for 2018 and following the methodology outlined by Bandiera et al. (2024).

Thus, these findings confirm that firms in the region face a large shortage of workers with the foundational skills required for their jobs. This shortage persists even though, according to PIAAC data, occupations in Latin America and the Caribbean generally demand lower foundational skills than those in more developed economies. The skills gap in the region is therefore not due to unusually high employer requirements. Measured skill demands are significantly lower than in the OECD, but many workers still lack the abilities needed to meet even modest requirements.

Studies using PIAAC also allow us to examine qualification mismatches—which occur when workers have educational qualifications that are above or below what is required for their current jobs—as well as field-of-study mismatches, which arise when workers' fields of study do not align with the requirements of their jobs. These forms of mismatch often overlap. For example, graduates who cannot find work in their field of study may accept jobs in other fields that are below their qualification level because they lack the specific knowledge required for the position. In such cases, workers are both overqualified and mismatched by field of study.

Qualification mismatches, based on workers' subjective reports of the qualifications required for their jobs, are common across countries participating in PIAAC. On average, about 22 percent of workers report being overqualified, while 12 percent report being underqualified. Ecuador stands out as an exception, with underqualification more common than overqualification. This likely reflects rapid growth in the demand for higher qualifications that has not been matched by an equivalent increase in the number of graduates. In contrast, Chile, Mexico, and Peru exhibit lower levels of overqualification than the OECD average. Field-of-study mismatches are also widespread. On average, 40 percent of workers globally are employed in occupations unrelated to their field of study, but the incidence is particularly high in the region. In Chile, it is about 10 percentage points higher than the OECD average; in Ecuador, 17 percentage points higher; and in Mexico, 12 percentage points higher. These mismatches are costly, not only for aggregate productivity but also for individual outcomes. In OECD countries, overqualified workers can earn approximately 17 percent less than those whose qualifications and jobs are well aligned (OECD 2019).

Overall, the skills gap analysis highlights two key issues:

a) Weak Foundational Skills: Skills development is a life-cycle process, and skills developed at each stage become the foundation for skills acquired at later stages. Earlier IDB work, such as *Disconnected* (Busso et al. 2012) and *Learning Better* (Busso et al. 2017), provides evidence that many of the region's socioeconomic differences in skill formation open in early childhood. Once children enter formal schooling, the gaps are amplified by the limited

capacity of the basic education system to provide minimum standards in foundational skills. About 75 percent of students complete schooling without basic foundational skills, as measured through PISA scores.⁴⁵ By the end of lower secondary school, 75 percent of 15-year-olds fall below minimum proficiency in mathematics, 55 percent in reading, and 57 percent in science, compared with OECD averages of 31 percent, 26 percent, and 24 percent. Deficits generated at the school level have lasting consequences for adult skills. Using a sample of 20 countries, Gustafsson (2016) shows that performance in numeracy and literacy in PIAAC is strongly correlated with earlier PISA achievement trends, even after controlling for educational attainment and overall levels of social development.

b) Signaling of Skills: It is difficult for employers to accurately measure worker quality before hiring, so they rely on qualifications as a signal of ability, but this has important implications. Evidence from Colombia shows that wages are affected by two independent components: the credential that workers hold, which can cause over- or underqualification, and the skills they possess, which can lead to over- or underskilling (Busso, Montaña, and Muñoz 2020). Degrees can signal program quality and selectivity, which reduces information frictions for employers, but skills represent actual productive capacity. Imperfect information and weak certification systems can produce higher degrees of field-of-study and qualification mismatches. Reducing information gaps and asymmetries can be productive for workers, especially the most disadvantaged. Busso, Montaña, and Muñoz-Morales (2025) show that salient field-specific signals can raise earnings by 7 to 10 percent in Colombia, particularly for graduates from lower-reputation institutions.

45. The Programme for International Student Assessment (PISA) is an international survey conducted by the OECD that measures 15-year-old students' ability to use their reading, mathematics, and science knowledge and skills to meet real-life challenges, rather than how well they have mastered a specific school curriculum.

BOX 6.1 MEASURING SKILLS MISMATCH: METHODS AND CHALLENGES

A skills mismatch is a broad and multidimensional concept that refers to a misalignment between workers' qualifications or skills and the requirements of their jobs. It can be measured at both the individual and aggregate levels and typically falls into three main categories: mismatches in qualification level, field of study, or specific skills needed for the job. Skills mismatch covers different situations, each with its own causes, effects, and impacts on workers, firms, and the labor market.

Different types of skills mismatch:

- **Vertical mismatch:** Refers to situations in which a worker's level of education or skills is above or below job requirements. This includes overeducation and undereducation—when a worker's educational qualifications do not align with the job's requirements—as well as overskilling and underskilling—when a worker's skills or competencies do not match what the job demands.
- **Horizontal mismatch:** Occurs when workers are employed in occupations that are unrelated to the main field of study of their highest qualification. It is mainly used as a proxy for field-specific knowledge. However, multiple studies have estimated that this type of mismatch lowers earnings and job satisfaction and increases turnover, a pattern found consistently in both developed and developing labor markets (McGuinness, Pouliakas, and Redmond 2018).

Types of skills mismatch, by level:

LEVEL OF MISMATCH	TYPE OF MISMATCH		DEFINITION
Individual level	Vertical mismatch	Over-/underqualification	Excess or insufficient educational qualifications relative to those required to do, or to get, the worker's current job.
		Over-/underskilling	Deficit or excess skills or competencies relative to what is required to competently perform the worker's current job.
		Skills obsolescence	Depreciation of previously acquired skills due to technological change or evolving job demands.
	Horizontal mismatch	Field-of-study mismatch	When a worker is employed in a job that is not related to the main field of study of the worker's highest qualification.
Aggregate level	Vertical/horizontal	Skill shortage/surplus	Demand for particular skills exceeds supply in the external labor market, creating a shortage of suitably qualified or skilled external candidates for a job, or vice versa.
		Skills gap	Members of the workforce do not have the required skills or abilities to competently perform their current jobs; the concept can also apply within a firm.

Source: McGuinness, Pouliakas, and Redmond (2018) and Quintini (2011).

6.3 When Experience Fails to Build More Skills

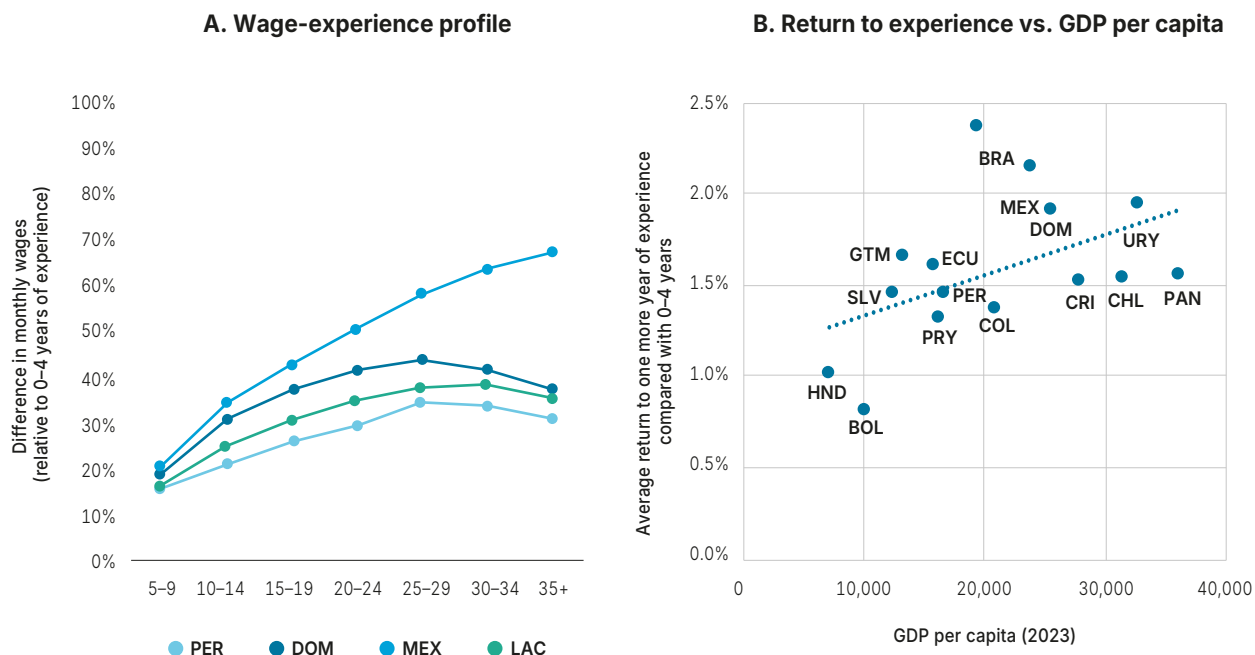
People are most likely to develop skills in the three places where they spend the most time: at home, in school, and in the workplace (Busso et al. 2017). In the earlier section, we focused on skills accumulated during formative years. However, human capital accumulation does not have to end when formal education does. Ideally, workers continue to complement and acquire new skills on the job or through adult training.

Unfortunately, evidence on wage returns to experience suggests that workers in Latin America and the Caribbean accumulate far less human capital on the job than workers in advanced economies (Jedwab et al. 2023). Additional years of experience translate only modestly into higher wages: whereas workers with 25 years of experience see cumulative wage gains of about 85 percent in advanced economies, in a sample of 15 Latin American and Caribbean countries, workers with the same level of experience accumulate wage gains of only around 35 percent over their careers (Islam et al. 2019). Analysis of wage profiles shows that wages rise relatively quickly at the beginning of workers' careers, but overall wage growth over time is fairly modest (Figure 6.2).⁴⁶

After 25 years on the job, workers in advanced economies see cumulative wage gains of about 85 percent; in Latin America and the Caribbean, the figure is only around 35 percent.

⁴⁶. Similarly, other studies find that wage-experience profiles tend to be steeper in countries with higher GDP per capita and higher levels of formalization (Donovan, Lu, and Schoellman 2023).

FIGURE 6.2 WAGE-EXPERIENCE PROFILES IN LATIN AMERICA AND THE CARIBBEAN



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, using the econometric framework of Islam et al. (2019) and Lagakos et al. (2018) for adults ages 18–65 in 15 Latin American and Caribbean economies.

Note: We compute each country's wage-experience profile as the average profile across the 2003–2023 sample to enable comparisons over time across countries with different time trends.

When skills formation on the job is limited, formal adult training becomes more important. In this respect, Latin America and the Caribbean face two main barriers. The first is inadequate provision of technical skills, either due to low quality in technical education and training or to a misalignment between the technical skills supplied and those demanded in the labor market. The second is information problems that prevent skilled and qualified workers from finding jobs where they would be better matched according to their skills. Labor policies that support firm-based training—such as subsidies for on-the-job training and apprenticeship programs—have been insufficient to overcome key barriers to firm investment in skills, including limited appropriability of training returns due to poaching and high worker turnover.

TVET and active labor market policies should, in principle, be designed to address both the skills supply problem among adults and the matching and information problem. In the following sections, we describe how these institutions operate in the region and examine their effectiveness in practice.

6.4 TVET: High Potential, Limited Results

The region has a long history of investing in technical and vocational education and training (TVET) as a key tool to equip individuals with the practical skills, technical knowledge, and competencies required for specific occupations or trades through a combination of classroom instruction and work-based learning. The mid-twentieth century marked a pivotal moment when several national training institutions in Latin America were established as part of state-led development and industrialization strategies, such as SENA in Colombia, INA in Costa Rica, and SENAI in Brazil. From the outset, these institutions were financed through earmarked payroll contributions, often shared between employers and workers, creating a stable funding base that has endured over time. The model later expanded to other countries, including INFOTEP in the Dominican Republic, HEART Trust NTA in Jamaica, and INEFOP in Uruguay. Today, at least 18 countries in the region maintain national training institutions financed through payroll contributions, sectoral levies, or a combination of tax credits and other sources.⁴⁷

Over time, the system has expanded and diversified, encompassing a wide range of providers and delivery modalities that are often classified into three types: formal, nonformal, and informal TVET. Formal TVET comprises technical and professional programs within the formal education system, leading to degrees or certifications. For example, some higher education institutions offer two-year technological programs that can be considered equivalent to associate degrees in the United States. Nonformal TVET refers to training offered outside the formal education system, where entry does not necessarily depend on prior formal education. This includes programs delivered by national training institutions, private institutes, and firms. Unlike formal TVET, which usually leads to degrees or certifications, nonformal TVET may improve skills and employability with or without formal accreditation. Informal TVET is characterized by learning by doing and skills acquisition through work experience. This type of learning often occurs in entry-level or low-skilled positions, where tasks are generally not complex, but skills gained informally can boost productivity and improve individual well-being (Hanni 2019).

TVET has evolved into an adaptable layer of the education and training system that has the potential to advance both economic and social inclusion goals. Regarding economic objectives, TVET programs are well positioned to foster a skilled workforce that responds to

47. Examples of payroll-financed: SENA (Colombia), INA (Costa Rica), INFOP (Honduras), INEFOP (Uruguay), INSAFORP (El Salvador), INADEH (Panama), INFOTEP (Dominican Republic), and HEART Trust NTA (Jamaica). Examples of sectoral levies: SENAI, SENAC, SENAR, and SENAT (Brazil), and SENATI (Peru). Examples of tax credit or mixed systems: SENCE (Chile), SECAP (Ecuador), and INCES (Venezuela).

the needs of the productive sector. On the one hand, their modular and flexible structure, in principle, allows for better responsiveness to labor market demands. On the other hand, many TVET systems design training based on occupational standards developed in consultation with industry.

In terms of social inclusion, in Latin America and the Caribbean, TVET provides valuable pathways for lower-income groups, who are more likely to enroll in these programs (Ferreyra et al. 2021). Shorter program durations reduce opportunity costs and contribute to higher completion rates compared with bachelor's degrees. The emphasis on practical skills also benefits youth and adults who may lack access to quality secondary education or struggle in academic programs. Furthermore, TVET is advantageous for people with disabilities and migrants, as many systems include mechanisms to evaluate and certify skills acquired abroad.

While this dual role is a strength—indeed, a channel to advance inclusion while supporting productive development through human capital investment—it can also become a drawback in practice. It often implies the involvement of too many stakeholders. Because TVET sits at the intersection of education and labor policy, ministries of education and labor are typically involved. But given its relevance for social inclusion and productivity, ministries of social protection, industry, and trade also play a role. This multiplicity of actors is often reflected in fragmented governance and financing arrangements, as discussed below.

6.4.1 Governance and Financing of TVET: Too Many Actors, Too Little Coordination

TVET in the region is delivered by a diverse range of actors and through various modalities. It involves a combination of public and private provision and, as mentioned earlier, can take formal, nonformal, or informal forms. Providers can include universities, public and private institutions, and national training agencies, such as SENAI in Brazil, INFOP in Honduras, and HEART in Jamaica, which, as discussed earlier, have historically played a particularly important role.

Oversight and governance of TVET systems vary across countries, reflecting diverse institutional arrangements. National training institutions are often established under the ministries of labor, while formal TVET is generally overseen by the ministries of education, although there are exceptions. In Trinidad and Tobago, the recently created Ministry of Tertiary Education leads the agenda and oversees the National Training Agency. In Jamaica, the human capital development agency HEART is a statutory body of the Ministry of Education, Skills, Youth and Information.

This separation of oversight between ministries of labor and education often results in a fragmented TVET system. Vocational training programs under the Ministry of Labor frequently operate independently of the formal TVET system managed by the Ministry of Education. This fragmentation carries several costs, including duplication of efforts, inconsistent quality standards, fragmented financing, and limited opportunities for student mobility and credit transfer between programs.

Fragmentation is also evident in TVET financing. Countries typically rely on a wide range of funding sources, including payroll taxes, earmarked levies, and tax deductions, which are often difficult to trace and account for comprehensively. While government budgets may provide information on the overall level of education spending, they usually lack the detail required to identify spending specifically allocated to TVET. In particular, few budgets specify the original sources of public funding for education or TVET, making it difficult to estimate total expenditure in the region (Hanni 2019).

Despite these data limitations, two stylized facts stand out. First, public funding for both formal and nonformal TVET is largely provided through supply-side subsidies, with resources flowing directly to providers, financed either through general taxation or employer-employee contributions. Second, funding allocations are generally not linked to performance or outcomes, but instead follow historical patterns, resulting in high budget stability and limited use of financing mechanisms to incentivize training quality. This is evident in public institutions delivering formal TVET at the secondary and postsecondary levels. These institutions are typically financed through general taxation, with budgets allocated based on historical patterns or input costs, such as enrollment levels or wage bills, rather than on measures of performance or strategic prioritization.

TVET funding flows largely through supply-side subsidies that are not linked to performance or outcomes, but instead follow historical patterns.

This is also the case for nonformal TVET provision, which, as discussed earlier, is often delivered through national training institutes and financed through payroll contributions. As shown in Table 6.2, employers contribute between 0.1 and 3.0 percent of payroll and, although direct employee contributions are rare, workers may indirectly bear part of the cost through lower wages. This financing model generates substantial and stable resources for some

institutions. As illustrated in Figure 6.3, funding can reach around 0.3 percent of GDP in cases such as INA in Costa Rica and SENA in Colombia, and as much as 0.7 percent of GDP in the case of HEART in Jamaica.⁴⁸

While this financing model grants national training institutions a degree of technical autonomy, it also imposes additional costs on salaried labor, which, as discussed in the next chapter, are already high by international standards in the region. Moreover, this separation between financing and broader education systems often leads these institutions to operate as institutional silos.

TABLE 6.2 TVET-RELATED CONTRIBUTION RATES, 2023

COUNTRY	MANDATORY CONTRIBUTION RATES		SPECIFIC APPLICABLE CRITERIA
	EMPLOYEE	EMPLOYER	
Barbados	None	None	
Chile	None	None	
Mexico	None	None	
Trinidad and Tobago	None	3%	
Jamaica	None	3%	
Argentina	0.5%	2%	Employer contribution paid quarterly
El Salvador	None	2%	
Colombia	None	2.0%	Workers earning more than 10 minimum wages
Panama ⁽¹⁾	1.25%	1.50%	
Venezuela	1.3%	1.5%	
Paraguay	None	1.0%	
Peru	None	1%	Firms classified in category D of the industrial classification system—industrial sector—with more than 20 employees
Uruguay	None	1%	
Brazil	None	1.0%	Industrial, commerce, and transport sectors
Costa Rica	None	1%	Firms with at least five permanent workers

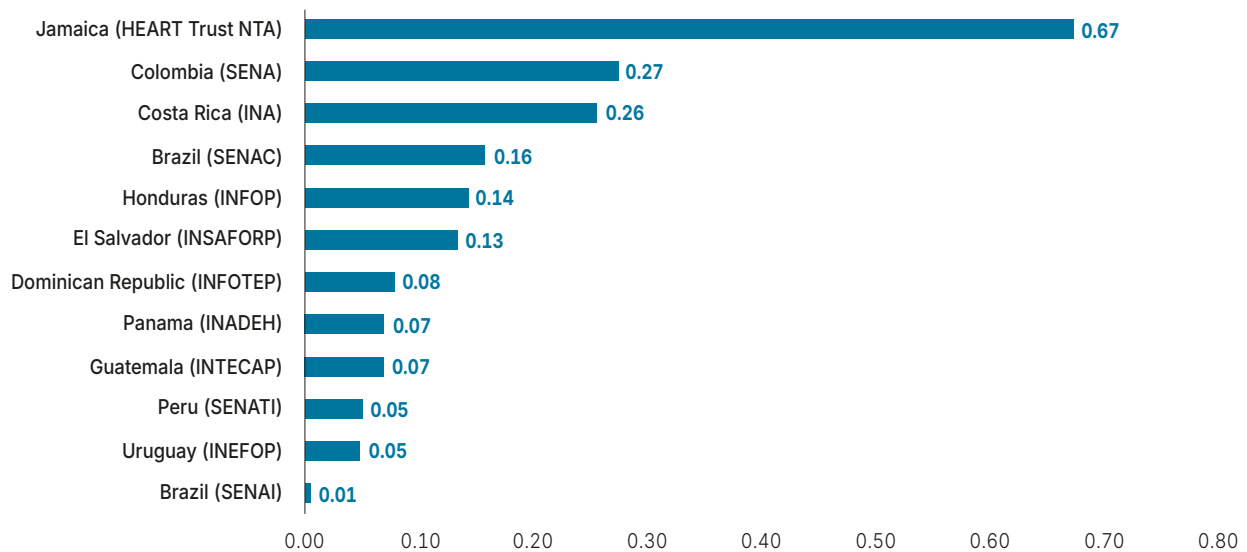
48. Direct estimates are not comparable with those for other regions. However, on average across OECD countries, governments allocated about 0.47 percent of GDP to upper secondary and postsecondary vocational programs, including 0.35 percent in public institutions, which also largely serve adult learners (OECD 2025).

COUNTRY	MANDATORY CONTRIBUTION RATES		SPECIFIC APPLICABLE CRITERIA
	EMPLOYEE	EMPLOYER	
Dominican Republic	0.50%	1%	
Guatemala	None	1%	
Honduras	None	1%	
Ecuador	None	0.75%	
Bolivia	0.10%	0.10%	

Source: Authors' compilation based on labor legislation in each country as of 2023.

Note: (1) Also finances public education.

FIGURE 6.3 FINANCING OF NATIONAL TRAINING INSTITUTIONS, CIRCA 2023
(PERCENT OF GDP)



Source: Authors' calculations based on national training institution data for each country and World Development Indicators (WDI). Data for all countries are based on 2023 estimates, except for El Salvador and Honduras (2022), the Dominican Republic (2019), and Jamaica (2021).

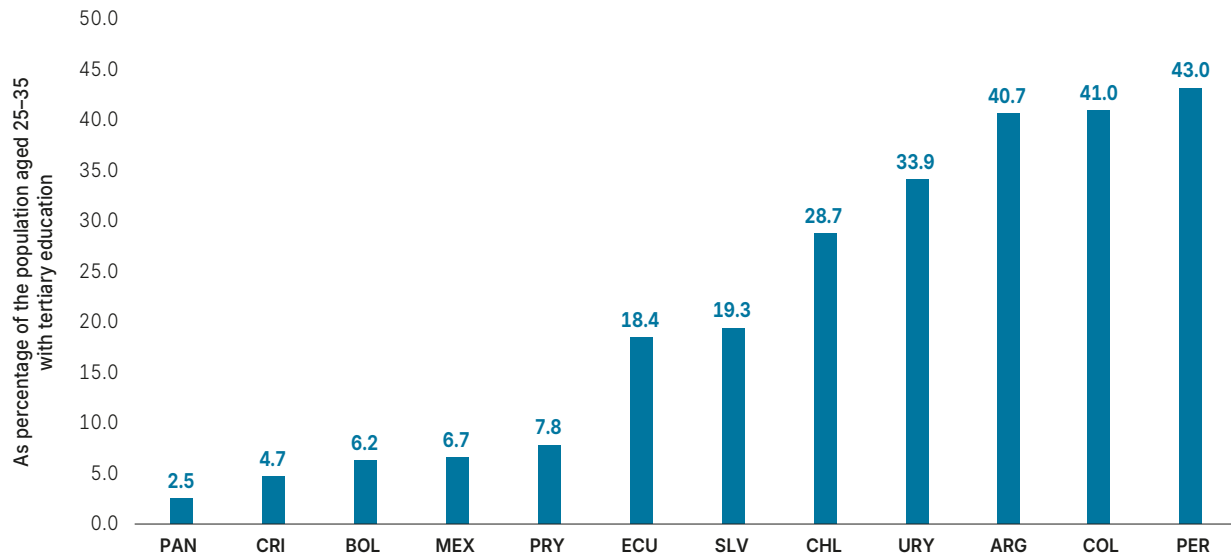
In most countries, public institutions providing TVET charge minimal or no tuition fees. As a result, public provision is heavily subsidized, particularly in fields with higher delivery costs. TVET programs can be more expensive than general education, especially in areas such as manufacturing, because of higher operating, equipment, and capital requirements. In addition, TVET entails extra costs associated with practical workplace training and the employment of specialized instructors (Ferreyra et al. 2021; Levin et al. 2024). According to Almeida et al. (2015), in 2008, enrolling a student in a Brazilian high school program integrated with technical education cost roughly three times as much as enrollment in the general academic track.

And while public provision is heavily subsidized, financial support for students attending TVET programs in formal private institutions is rare. Indeed, one of the most salient features of TVET financing is the limited use of demand-side subsidies. Some countries offer or guarantee student loans for TVET, but these schemes typically have very limited coverage (Ferreyra et al. 2021).

As a result, TVET financing relies largely on supply-side subsidies, with governments funding public training institutions or contracting private providers and paying based on inputs. Performance monitoring is limited. Providers mainly track administrative indicators such as enrollment, and program success is measured by the number of students served. Indicators related to graduate employability are rarely collected and are seldom linked to incentives. This pattern is common not only in Latin America and the Caribbean, but also in many low- and middle-income countries in Asia and Africa (Levin et al. 2024).

6.4.2 Postsecondary TVET: A System That Has Not Scaled

Comprehensive data on access to TVET across all delivery modalities and levels remain limited, reflecting differences in national reporting systems and the fragmentation of provision. Nevertheless, available information allows for an analysis of postsecondary formal and nonformal TVET, which in the English-speaking Caribbean typically leads to associate degrees, while in other parts of the region it results in technical or technological diplomas. The analysis highlights considerable variation in the role of TVET within postsecondary education. TVET is relatively widespread in some countries: in Argentina, Colombia, Peru, and Uruguay, one-third or more of individuals ages 25–35 have completed a postsecondary technical program. By contrast, in Bolivia, Costa Rica, Mexico, Panama, and Paraguay, this share is below 9 percent (see Figure 6.4).

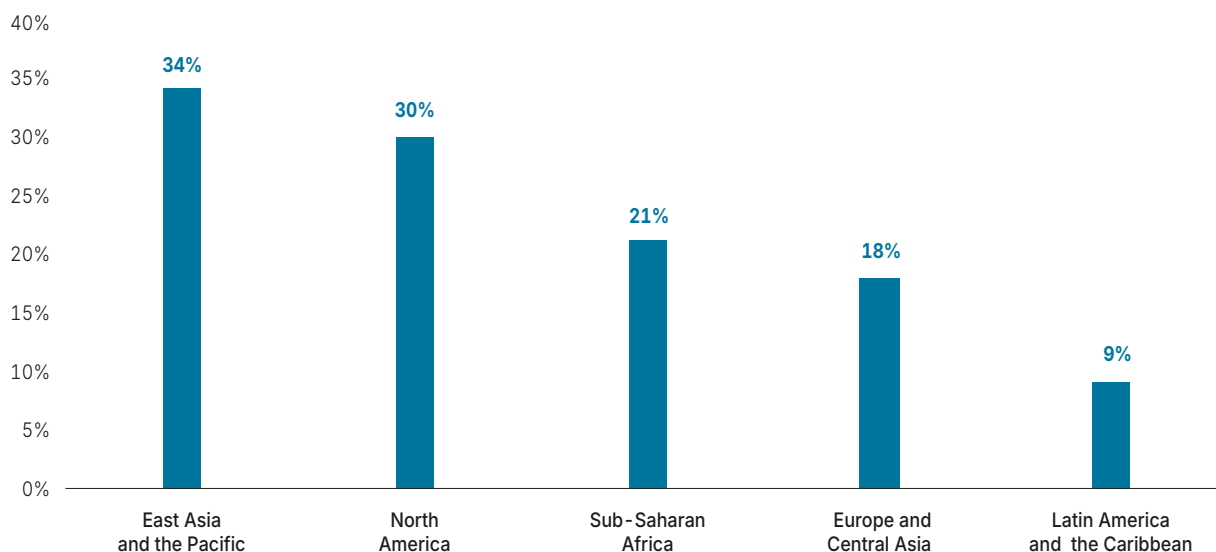
FIGURE 6.4 SHARE OF POSTSECONDARY GRADUATES WITH A TVET QUALIFICATION, CIRCA 2023


Source: Authors' calculations using data from IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: Measuring TVET through household surveys is challenging due to differences in education regulations, program availability, and inconsistent definitions across countries. Results may not represent directly comparable categories. Data for Mexico, Bolivia, and Panama correspond to 2022.

This variation is also reflected in the pace of growth. Growth in postsecondary TVET, measured by new entrants to two- or three-year programs, has been slower in Latin America and the Caribbean than in other regions. Currently, only 9 percent of postsecondary students in Latin America and the Caribbean enroll in technical programs, compared with about 30 percent in North America, 34 percent in East Asia and the Pacific, and 44 percent in the OECD (Ferreira et al. 2021). Despite this, several countries are making substantial investments to expand the sector. For example, Brazil doubled its investment in technical education as a share of GDP between 2003 and 2016 (Elacqua et al. 2019).

FIGURE 6.5 SHARE OF POSTSECONDARY STUDENTS ENROLLED IN TWO- OR THREE-YEAR TVET PROGRAMS



Source: Ferreyra et al. (2021).

With respect to progression, completion rates in postsecondary TVET programs, including both formal and nonformal options, are generally higher than those observed in bachelor's degree programs. A recent study comparing completion rates in 15 countries⁴⁹ finds that, in all but three of them, postsecondary TVET students are more likely to complete their programs than bachelor's students (Ferreyra et al. 2021). However, students who enroll in technical high schools may differ systematically from those who choose academic programs, making simple comparisons misleading. A recent study in Brazil addresses this issue by explicitly controlling for selection factors and comparing students with similar observable characteristics. The authors find that students in technical high schools have significantly lower dropout rates than comparable students in general academic schools, indicating that the technical track itself contributes to better progression outcomes (Elacqua et al. 2019).

Despite these advantages, dropout rates in postsecondary TVET remain substantial. On average, about one-third of students leave their programs before completion, and in some cases the share can approach one-half. Analyses consistently show that the main reason for leaving is financial difficulty (Ferreyra et al. 2021).

⁴⁹. Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, and Uruguay.

Addressing these financial barriers is essential, since students in postsecondary TVET programs, in formal or nonformal tracks, tend to come from more disadvantaged socioeconomic backgrounds than those pursuing bachelor's degrees. For example, 14.4 percent of TVET students belong to the poorest quintile, compared with only 8.9 percent of bachelor's students, while only 19.3 percent of TVET students come from the richest quintile, compared with 35.0 percent among bachelor's students (Ferreyra et al. 2021). These enrollment patterns highlight the importance of alleviating financial constraints to improve student retention and completion, as underscored in Chapter 8.

6.4.3 A Binding Constraint: Instructor Capacity

If countries in Latin America and the Caribbean were to expand TVET, one of the main constraints would be the limited availability of qualified teachers and the capacity to deliver instruction that imparts occupation-relevant skills and motivates learners. As in many parts of the world, TVET systems in the region face acute shortages of instructors. A study by UNESCO covering Bolivia, Colombia, Ecuador, and Venezuela reports that there are not enough professionally trained TVET teachers, especially in rural and underserved areas. Moreover, many of the teachers who are in place do not have the pedagogical or technical competencies required, creating a quality shortage as well as a numerical one (Borja, Cortez, and Carrillo 2021). Similar challenges are documented by the OECD in Brazil, where the expansion of TVET has been slowed by a lack of qualified instructors (OECD 2022).

Underlying these shortages is the absence of a coherent human resource strategy for TVET, a problem that is aggravated by institutional fragmentation. In the four countries analyzed by UNESCO, teacher preparation is highly uneven and standards vary widely across institutions and programs. In several cases, ministries and regulatory agencies do not even maintain basic administrative information, such as the number, location, or qualifications of TVET teachers, or the requirements they are expected to meet. Opportunities for both initial preparation and continuous teacher training are also limited. Existing programs tend to be insufficient, inconsistent, and poorly aligned with technological and sectoral needs.

This is especially problematic because TVET instructors who come directly from industry often lack formal preparation as teachers. At the same time, many TVET students face significant academic gaps that require instructors with strong pedagogical skills and sensitivity to diverse learning needs. On the other hand, TVET instructors often possess solid pedagogical skills, as they are trained teachers, but may lack hands-on industry experience—a pattern commonly observed in TVET institutions across the region. In TVET, practical expertise and up-to-date familiarity with industry trends are essential complements to pedagogical competence. Moreover, none of the countries examined have established

a consistent professional development pathway for TVET teachers, making it difficult for instructors to remain current with technological change and evolving industry practices (Borja, Cortez, and Carrillo 2021).

These gaps matter because TVET instructors are expected to combine strong industry-based technical knowledge with effective pedagogical skills, including the ability to teach socioemotional competencies and address foundational learning gaps. Without a structured approach to recruiting, training, and supporting instructors, countries will struggle to deliver high-quality TVET at scale.

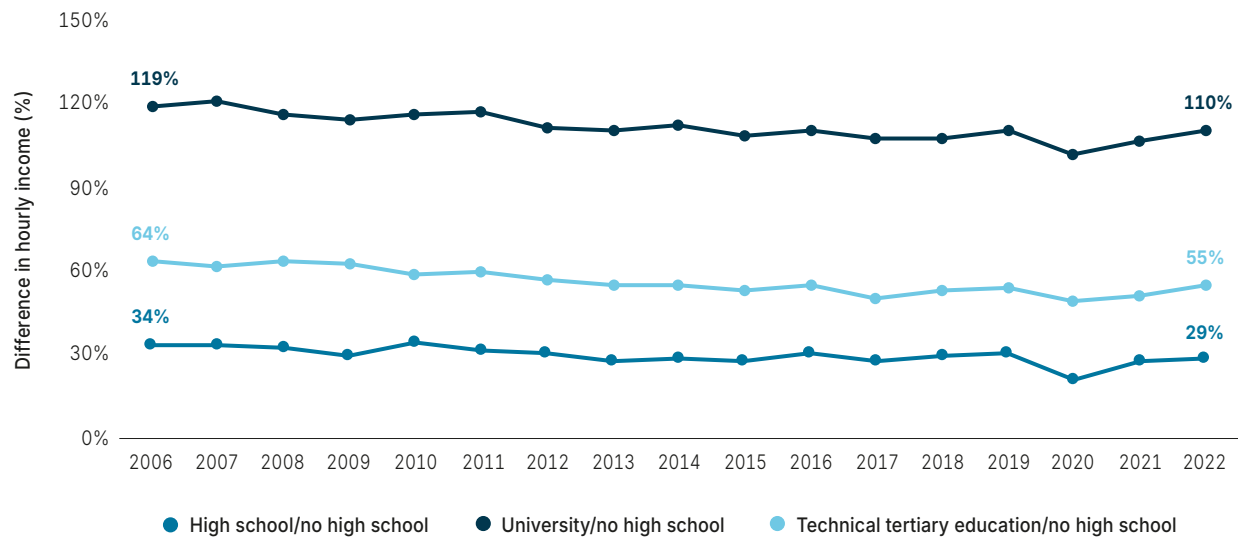
6.4.4 Stigma and Returns to Technical and Vocational Education

Stigma remains a significant barrier to the expansion and effectiveness of technical and vocational education and training in Latin America and the Caribbean. TVET is often perceived as a second-tier track, associated with lower academic ability and limited economic opportunities (Ferreya et al. 2021). This perception persists despite consistent evidence that TVET can deliver positive labor market returns.

For example, as shown in Figure 6.6, TVET graduates have earned higher wages than high school graduates for several decades, even after controlling for sex, age, marital status, occupation, and industry. Although this wage premium has declined over time—possibly reflecting program expansion or reductions in quality—TVET graduates still earn wages about 55 percent higher than workers without a high school education, exceeding the premium associated with completing high school.

TVET graduates still earn wages about 55 percent higher than workers without a high school education—exceeding the premium from completing high school itself.

FIGURE 6.6 RETURNS TO SCHOOLING FOR SALARIED WORKERS BY HIGHEST DEGREE COMPLETED, 2006–2022



Source: Authors' calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean for adults aged 25–65 in Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Panama, Peru, and Uruguay. Estimates are based on a Mincerian equation controlling for sex, age, marital status, type of occupation—cognitive or noncognitive—and type of industry—agriculture or nonagriculture.

However, these wage premiums do not incorporate the direct and indirect costs of schooling, such as tuition and fees, or the opportunity cost of forgone labor earnings. This distinction matters, as these costs, especially opportunity costs, can be substantial. Studies that account for them find that, on average, postsecondary technical degrees in countries such as Colombia, Chile, and Peru generate positive returns, but with wide variation. Some programs deliver high returns, comparable to or even exceeding those of university degrees, while others yield low or even negative returns, meaning that graduates' earnings do not fully cover the cost of the program. Importantly, this variation can occur even within the same field of study, as outcomes depend heavily on the institution offering the program. The share of graduates facing negative returns can be sizable. In 2014, for example, between 51 and 59 percent of TVET graduates in Colombia and Chile experienced negative net economic returns, indicating that the programs they chose were not worth their cost (González-Velosa et al. 2015; Ferreyra et al. 2021).

In this context, investing in TVET can be a risky gamble for students. Many enroll with limited information about expected earnings or employment outcomes across programs. The wide dispersion in returns underscores the importance of strengthening systems

that ensure quality, align training with labor market needs, and provide better guidance to students. As discussed below, while countries in the region invest in these areas, significant weaknesses remain.

6.4.5 Quality, Relevance, and Permeability Challenges

Countries in Latin America and the Caribbean have implemented policy efforts and guidelines to enhance the relevance, quality, and permeability of TVET, which are three attributes often identified as key policy goals. Quality involves providing the resources and conditions necessary for students to effectively acquire skills. This includes well-trained instructors, appropriate pedagogical tools, and adequate equipment for both theoretical and practical training. Relevance refers to aligning TVET with labor market demands, ensuring that programs and curricula equip workers with the skills needed in the productive sector. Permeability reflects the system's ability to enable learners to navigate different educational pathways and validate their outcomes across formal and informal settings. This could mean, for example, recognizing TVET qualifications acquired in nonformal settings for entry into universities.

In an ideal scenario, countries would have a unified quality assurance system with clear and consistent criteria applied to all providers. Such a system would monitor key elements of learning, including instructor preparation, standards for teaching and learning environments, availability of equipment, and mechanisms for assessment and feedback, such as graduate tracking. A single authority would be responsible for overseeing these processes and ensuring that all providers are evaluated based on the same criteria. In practice, however, most countries in the region lack these integrated structures.

Colombia illustrates this fragmentation. The public training institution, SENA, is subject to different quality assurance processes depending on the type of program, with the Ministry of Education in charge of oversight for some programs and the Ministry of Labor in charge of others (Chaparro and Maldonado 2022). Similarly, in Trinidad and Tobago, the National Training Agency (NTA) is primarily responsible for coordinating, planning, and implementing quality assurance and standards for TVET, while the Accreditation Council of Trinidad and Tobago (ACTT) oversees the quality of tertiary education. As a result, postsecondary TVET programs can fall under the remit of both agencies. However, there is no unified legal framework that explicitly delineates and sets limits on the responsibilities of ACTT and NTA or clarifies the scope and sequence of their respective functions (Duncan 2025). Peru also faces coordination challenges across the institutions responsible for TVET. There is no alignment in quality standards or oversight among the Ministry of Education's provision of training, the occupational classification mechanisms it manages, the Ministry of Labor's policies and

services, and the vocational training offered by private institutions. A final example comes from Brazil, where the Basic Guidelines on Education Act contains a number of provisions on standardization and accreditation, but there are no means of coordination between education and training for work. This lack of coordination creates inconsistencies and gaps in regulation and weakens the overall quality assurance system.

Additionally, quality standards in postsecondary TVET programs are often adapted from formal academic education and do not reflect the specific characteristics of TVET. For example, SENA's tecnólogo programs in Colombia are reviewed using criteria designed for bachelor's degree programs, even though the nature of TVET is fundamentally different. This creates practical challenges, including in the assessment of instructors. In TVET, the quality of instruction depends largely on an instructor's industry experience and mastery of practical skills, whereas in university education, quality is usually assessed based on academic credentials and research output. These differences underline the need for quality standards that are tailored to TVET rather than borrowed from academic models, as discussed in Chapter 8.

A fundamental challenge in these systems is the limited focus on results. The key issue is not only the quality of instructors or the adequacy of learning environments, but also whether students acquire skills. Assessments that measure learning progress—for example, changes in specific technical and foundational skills before and after training, benchmarked against industry standards—are rare. This gap is particularly important given the widespread deficits in foundational skills observed in several countries, as discussed earlier. A lack of reliable assessment also has direct implications for employability. In Brazil, the OECD warns that unreliable assessment practices weaken the credibility of many TVET qualifications, making certificates less meaningful for employers and reducing their value in the labor market (OECD 2022).

Another fundamental shortcoming is the lack of systematic assessments of graduate employability and employer satisfaction. A clear example is that national training institutions typically report the number of students served but rarely track or publish data on the labor market outcomes of their graduates. This information is critical, as it can reveal gaps in relevance and inform adjustments to program design. For instance, a recent tracer study conducted by the National Training Agency in Trinidad and Tobago found that 40 percent of graduates from training programs rarely or never use the skills they acquired in their current jobs (NTA 2022).

Limited attention to employability also undermines households' ability to make informed career decisions. TVET landscapes are often confusing, with many programs of uneven quality and highly heterogeneous labor market returns. Without reliable information, choosing a training program becomes a risky gamble for many students. A notable exception in the region comes from Chile, which has invested in a robust public information platform, *mifuturo.cl*. As described in Chapter 8, the platform uses administrative data, including tax records and social security contributions, to publish detailed indicators on employment rates and graduate earnings by institution and field of study for the entire tertiary system, including TVET programs. This kind of transparency helps students understand the likely labor market value of different programs and strengthens accountability across providers.

Focusing exclusively on inputs, such as infrastructure or learning materials, without tracking employability outcomes can lead to costly policy failures. A clear example is the major TVET reform undertaken in El Salvador, one of the most ambitious efforts in the region to improve training quality and relevance. The reform expanded training centers, invested heavily in upgrading teacher skills, and provided scholarships to increase access for disadvantaged youth. Although these investments increased enrollment and improved learning outcomes, an evaluation by the World Bank, UNESCO, and ILO found that the reform did not improve employment or earnings for graduates. According to the report, the central weakness was the lack of structured engagement with employers: training providers were not required or supported to align curricula, competencies, and program design with actual labor market needs. As a result, the system improved capacity but not labor market relevance (Levin et al. 2024).

*Latin American countries
lack integrated labor
market information
systems to guide
TVET planning and
improve relevance.*

6.4.6 Institutional Mechanisms to Improve Relevance

Labor Market Information Systems. Ensuring relevance requires strong tools to anticipate skills demand. Ideally, countries would combine employer surveys, analysis of online job platforms, administrative wage data, and macroeconomic projections to inform curriculum design and qualification standards (Amaral et al. 2017). While most Latin American and Caribbean countries have some initiatives of this type, they tend to be isolated and fragmented, with little influence on actual training provision. To our knowledge, no country in the region has an integrated labor market information system that regularly consolidates these tools to guide TVET planning, as is common in advanced economies such as Australia, South Korea, the United Kingdom, and Germany. Even when high-quality data exist—for example, Peru's survey of occupational demand—these insights are rarely used to adjust programs or guide institutional decisions, reflecting the broader fragmentation described earlier.

This pattern is consistent with findings from low- and middle-income countries globally. A recent international survey of TVET managers in 56 countries, including several from Latin America and the Caribbean, found that only 18 percent regularly use labor market information to update qualification systems, while the rest either do not produce such information or fail to use it in training decisions. This highlights a core challenge: without systematic, institutionalized mechanisms to connect labor market intelligence to the design and delivery of TVET, systems struggle to produce graduates whose skills match employer needs (Levin et al. 2024).

Qualifications Frameworks (QFs). This section examines whether qualifications frameworks can realistically deliver their intended outcomes, and what international experience suggests about their limits and design trade-offs. Many countries in the region have invested significant efforts in the development of QFs. These frameworks are structured systems that classify qualifications according to learning outcomes—such as knowledge, skills, and competencies—and organize them hierarchically by levels of complexity. Their development began in the late 1980s, and despite ongoing debates (see, for example, Allais 2017), adoption has expanded rapidly worldwide. Today, more than 140 countries have implemented national qualifications frameworks (NQFs) (Castel-Branco 2021), and Latin America and the Caribbean are no exception, with at least 15 countries initiating implementation processes. The region has also begun building regional qualifications frameworks (RQFs), including those developed by CARICOM and the Pacific Alliance.

The fundamental principle of NQFs is defining qualifications in terms of learning outcomes, independent of the type of institution or academic program. NQFs aim to reduce information asymmetries by defining, in terms of skills and knowledge, what each qualification represents

and strengthening quality assurance by linking programs to explicit and verifiable learning outcomes. They can also be used to promote labor mobility across countries, such as through the CARICOM regional qualifications framework. In principle, this can facilitate transitions across education pathways, between countries, or both.

NQFs in the region vary in scope, structure, content, and function. Some countries are developing comprehensive NQFs covering all levels of education and training, such as Brazil, Colombia, Mexico, Panama, Peru, and the Dominican Republic, while others limit them to TVET levels, such as Chile and Costa Rica. Additionally, some frameworks are expected to have regulatory functions, such as those in Costa Rica, Panama, and the Dominican Republic, whereas others are purely referential (ILO/Cinterfor 2021). They also differ in policy objectives, with some emphasizing the social recognition of technical education, while others prioritize articulating academic and vocational training systems.

Despite their widespread adoption, to our knowledge, no independent studies have evaluated the effectiveness of NQFs in the region. This may be due to the relative novelty of these frameworks and their gradual implementation. However, we can draw four key lessons from global analyses of their implementation processes.

1. Populating an NQF is costly and challenging at scale. In some countries, the criteria for defining qualifications are unclear. It is essential to use objective selection criteria when prioritizing sectors, considering factors such as labor market relevance and the country's economic agenda. Notably, qualifications can have a more significant impact in certain sectors—such as those with regulatory standards or a high concentration of mobile workers.
2. Trade-offs exist between different objectives assigned to NQFs. In some cases, NQFs define not only learning outcomes but also curricular content, teacher profiles, or program duration. When NQFs have a regulatory role, excessive prescription leads to inflexibility or high monitoring costs. In contrast, for referential NQFs, such overspecification may have little impact.
3. NQFs are tools that cannot improve system performance in the absence of complementary measures that promote relevance and quality. Lessons from countries with mature NQFs indicate that additional quality assurance mechanisms are essential to enhance system inputs. While learning outcomes are critical, institutional reputation, resources, faculty quality, and learning environments are equally important for system effectiveness. For instance, in Jamaica, employer preferences indicate that institutional reputation matters more than specific qualifications (Allais 2017).

4. Finally, evidence from successful NQFs, such as those in Scotland and France, shows that their effectiveness results from incremental, long-term processes. In these countries, the NQF evolved over many years through continuous dialogue with industry, regular updating of occupational standards, and steady improvements in assessment and certification systems (Allais 2017).

In summary, successful NQFs tend to be incremental and simple. They avoid trying to address too many objectives at once, focus on qualifications where they can add value, and do not attempt to replace other essential mechanisms, such as financial incentives to improve quality and relevance or existing quality assurance systems.

Certification Systems. One approach explored in the region to link work experience with formal recognition is certification of prior learning. This process formally assesses and certifies skills that individuals have acquired through work or other noneducational experience. Mexico's CONOCER and Chile's ChileValora are public institutions created specifically to assess and certify individuals' skills. In other countries, national training institutions partner with industry to develop certification processes, as is the case with INSAFORP in El Salvador, SECAP in Ecuador, INTECAP in Guatemala, and SENA in Colombia.

Despite these efforts, certification remains limited. According to ILO/Cinterfor (2021), the share of certified workers relative to those trained is low: 7 percent in ChileValora, 13 percent in CONOCER, and 1 percent in INTECAP. Strengthening these certification systems is warranted, as evidence from developed countries discussed in Chapter 3 shows that recognized certification improves signaling to employers and can enhance labor market outcomes. However, as will be discussed in Chapter 8, it is also crucial that these certifications be well recognized and have a good reputation among employers.

Sector-Level Consultative Bodies. Countries in the region have also frequently invested in sector-level consultative bodies, such as sector skills councils, *mesas sectoriales*, and *consejos sectoriales de competencias*, designed to gather information from employers and align training with labor market needs. These bodies usually bring together employers, training providers, and government agencies to identify the skills required in specific industries. In many cases, they produce occupational profiles or catalogs of qualifications that feed into NQFs and guide curriculum design. Their functioning varies widely: some operate permanently, while others are convened only occasionally to update standards or respond to emerging needs.

Despite their potential, these bodies can easily become fragmented and unfocused. Evidence from an independent evaluation of SENA's Mesas Sectoriales in Colombia illustrates this challenge. SENA leads an overly large number of these bodies, approximately 87, which in principle must develop occupational standards but have become duplicative, with unclear mandates and very narrow scopes (Econometría Consultores, Oportunidad Estratégica, and SEI 2014). Proliferation of these structures not only creates inefficiencies but can also hinder worker mobility. For example, there is little justification for maintaining separate bodies to define occupational standards for refrigeration technicians in the food industry and in the pharmaceutical industry when the core job functions are essentially the same. Thus, as discussed in Chapter 8, streamlining sector-level consultative bodies and promoting cross-industry standards where appropriate can improve coherence and reduce administrative burdens while supporting more flexible labor markets.

To sum up, the region features public and institutionalized vocational training systems that have succeeded in mobilizing stable funding, delivering curricula, and providing teacher training. Yet despite these achievements, many countries continue to face significant challenges in ensuring program quality and evaluating key outcomes such as learning and employability. Across much of the region, the capacity to monitor results, enforce standards, and assess whether training translates into improved job opportunities remains limited. As noted earlier, financing mechanisms generally do not provide incentives to promote training quality.

6.4.7 Unlocking the Promise of Apprenticeships and Work-Based Learning

Work-based learning is a core component of many TVET systems. It combines classroom instruction with practical training in the workplace. This approach is often embedded in apprenticeship contracts that are explicitly defined in labor regulations. In practice, apprenticeships are formal jobs that combine paid on-the-job training with related technical classroom instruction to develop occupation-specific skills. Ideally, this training leads to a certification that is recognized by industry upon completion (Fazio, Fernández-Coto, and Ripani 2016). As a result, apprenticeships can ease school-to-work transitions for youth and provide firms with a source of skilled labor aligned with their needs.

Evidence from Europe shows that TVET graduates who participated in work-based learning (e.g., apprenticeships) earn higher wages and face shorter unemployment spells (Riphahn and Zibrowius 2016). In Spain, dual training programs that combine classroom and workplace learning have increased job duration, wages, and worker retention (Bentolila, Cabrales, and

Jansen 2023). International evidence also suggests that apprenticeships are often a profitable investment for firms, which can recover most training costs, while apprentices benefit from better long-term career trajectories (Lerman 2019).

In Latin America and the Caribbean, however, evidence on the effectiveness of apprenticeships remains limited (Novella and Pérez-Dávila 2017). A notable exception is Brazil, where a large-scale apprenticeship program increased the likelihood of permanent employment, reduced turnover, raised reservation wages, and improved educational attainment (Corseuil et al. 2019).

Despite their potential, apprenticeship programs remain uncommon in the region and reach only a small share of the population. By OECD standards, incidence is low. In most countries, there is less than one apprentice per 1,000 workers. Colombia, through SENA, has the highest rate in the region, at about 17 apprentices per 1,000 workers, followed by Brazil's S System, with around five. In contrast, Austria, Switzerland, and Germany report between 32 and 45 apprentices per 1,000 workers (ILO/Cinterfor 2021).

Regulatory frameworks governing apprenticeships vary widely across countries. In Brazil, labor laws include specific provisions for apprenticeship contracts, often tied to structured on-the-job training. In Peru, labor legislation defines seven types of modalidades formativas laborales, including apprenticeships, internships, and other forms of workplace training. Similarly, Colombia integrates its apprenticeship program into a special provision within labor law, offering opportunities at different levels, from operators and assistants to technical roles. A distinctive feature of Colombia's approach is the mandatory hiring of apprentices by firms with 20 or more employees, with noncompliant companies required to make payments to SENA. In Trinidad and Tobago, newer legislation reflects a growing interest in promoting apprenticeships. These regulations often establish alternative contractual formats that lower labor costs for firms, as apprentices are compensated partially through human capital accumulation (Duncan 2025).

In most of the region there is less than one apprentice per 1,000 workers; in Austria, Switzerland, and Germany the figure is between 32 and 45.

Expanding apprenticeship programs in the region—and scaling them without sacrificing quality—poses several challenges. One key obstacle is firm structure: most firms are small and often lack the capacity to absorb the costs associated with apprenticeships. High levels of informality further complicate the enforcement of quality standards and increase the risk that firm-sponsored apprenticeship programs merely subsidize jobs that firms would have created anyway, or even lead to negative outcomes such as the exploitation of apprentices and interns.

Another challenge is the risk of poaching, which discourages firms from investing in training when apprentices may be hired away by competitors. In addition, many firms lack institutional support and awareness of how apprenticeships can improve productivity and profitability, while government agencies often lack the resources needed to ensure quality. Evidence from Chile illustrates these difficulties. Graduates of four-year upper secondary TVET programs are required to complete a four-month workplace placement to obtain their certificate, yet these placements are weakly integrated into the curriculum, quality assurance is uneven, and about half of students do not complete the workplace training component. In some cases, regulation itself becomes a constraint. In Brazil, for example, legal barriers limit the ability of schools to build stronger partnerships with employers. Public schools are not permitted to offer apprenticeship programs, which restricts their expansion and limits opportunities for work-based learning.

6.5 The Untapped Potential of Active Labor Market Policies

ALMPs are essential components of social protection systems. They aim to help individuals find work, enhance their skills, and prevent job loss through various services, such as labor market training and certification, public employment programs, employment subsidies, employment intermediation to connect job seekers with vacancies, and support for entrepreneurship. ALMPs are defined in contrast to passive labor market policies, which aim to provide income protection to job seekers—through instruments such as unemployment benefits, which may be insurance-based or assistance-based—without attempting to improve labor market performance.

As social protection policies, ALMPs are typically targeted at unemployed or disadvantaged populations and include:

- Placement and related intermediation services, such as information services, referral to job opportunities, job-search assistance, counseling, and case management of job seekers
- Training, such as institutional or on-the-job training, remedial education for disadvantaged youth, and subsidies to employers who offer training
- Subsidized employment in the private sector, such as wage subsidies, tax benefits, and social security discounts to incentivize the hiring of the most vulnerable groups
- Public works programs, such as temporary public employment programs and infrastructure and community service employment initiatives
- Vocational rehabilitation, such as programs for workers with disabilities or reintegration programs for former inmates

In addition to their role in social protection, ALMPs have, in principle, the potential to enhance labor productivity by reducing the loss of human capital and improving the quality of matches between employers and employees. They may also serve a countercyclical function, as investments in ALMPs often increase during economic downturns. For example, public works programs were widely implemented in the region during the economic downturn of the 1980s (ILO 2023). Similarly, during the pandemic, countries in Latin America and the Caribbean took rapid action by introducing policies to protect individuals who lost their jobs, as well as wage subsidies to prevent dismissals (Pagés et al. 2021).

Active labor market policies can be justified by several interrelated market failures that limit the efficiency and equity of labor market outcomes. First, as discussed in Chapter 3, labor markets are often characterized by significant search and matching frictions that slow worker reallocation across firms, sectors, and regions. Job seekers frequently face imperfect or incomplete information about available opportunities, while firms struggle to identify candidates with the appropriate skills and set wages, resulting in prolonged unemployment spells, unfilled vacancies, and suboptimal matches that reduce overall productivity.

Second, there is a tendency toward underinvestment in human capital. Education, training, and skills development generate positive externalities that benefit not only individuals and firms but also the broader economy. Yet households often face liquidity constraints that limit their ability to finance training, particularly during periods of unemployment or transition. At the same time, firms may be reluctant to invest in workers' skills due to concerns about employee turnover and poaching. These challenges are compounded by information frictions that can lead to misalignment between training investments and actual labor market needs, further reducing the effectiveness of private investment in skills.

Finally, labor markets are shaped by inequalities in access to information and networks, which constrain social mobility and reinforce existing disparities. Many job seekers rely heavily on personal connections to find employment, placing individuals from lower-income or marginalized backgrounds at a disadvantage due to weaker professional networks and limited access to timely labor market information. As a result, these workers may accept lower wages or poorer job matches than their skills would warrant. Employer biases, whether explicit or implicit, can further restrict opportunities for certain groups, reinforcing inequities and limiting upward mobility. By addressing these failures, ALMPs can improve both the efficiency and the fairness of labor market outcomes.

6.5.1 Fragmented Programs and Little Coordination

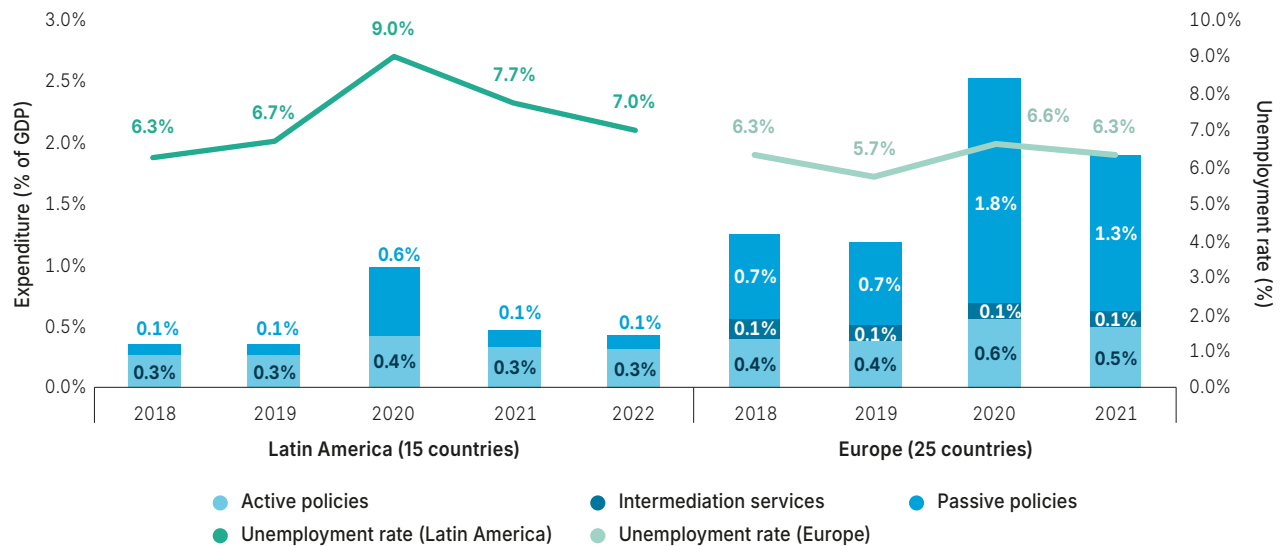
Over the past two decades, ALMPs in Latin America and the Caribbean have expanded significantly, with program offerings increasing by an estimated 20 percent over the last 10 years, particularly targeting youth unemployment. Among these, training programs are the most common intervention, representing 39 percent of total initiatives, while direct employment creation remains the least prevalent, at just 4 percent. Labor intermediation services account for 19 percent of ALMPs (Espejo et al. 2023; Figueroa and Holz 2023).

Despite the expansion in the number of interventions, expenditures on ALMPs in the region remain low, averaging around 0.3 percent of GDP, with a temporary increase to 0.43 percent in 2020 during the pandemic (Figure 6.7). In contrast, Europe allocates about 0.64 percent of GDP to ALMPs and employment intermediation services. Passive labor market policies account for even larger expenditures in Europe, at 0.67 percent of GDP before the pandemic and 1.27 percent in 2021, compared with Latin America and the Caribbean's 0.09 percent and 0.14 percent, respectively (Espejo et al. 2023).

Latin America and the Caribbean spends about 0.3 percent of GDP on active labor market policies—less than half the roughly 0.64 percent that Europe allocates.

This disparity reflects the fact that, unlike in advanced economies, the integration of passive and active labor market policies remains limited in the region. With some exceptions, such as Argentina, Colombia, and Chile, most countries do not require beneficiaries of unemployment benefits to engage with public employment services (PES) or ALMPs (Nunn 2024). Thus, while ALMPs are ideally linked to unemployment benefits to facilitate rapid transitions and reduce long-term welfare dependency, this connection is rare in the region due to the lack of income support for job seekers.

FIGURE 6.7 AVERAGE ANNUAL EXPENDITURE ON ACTIVE AND PASSIVE LABOR MARKET POLICIES IN LAC AND IN EUROPE, 2018–2022 (LAC) AND 2018–2021 (EUROPE)



Source: Authors' elaboration, based on Espejo et al. (2023).

Note: Data for Latin America and the Caribbean cover 2018–2022; data for Europe cover 2018–2021. Bars show expenditure as a percentage of GDP (left axis); lines show the average unemployment rate (right axis).

However, the generosity and coverage of unemployment benefits create an important contextual difference between the settings of ALMPs in Latin America and the Caribbean and those in which they emerged in Europe and North America. In advanced economies, relatively generous unemployment benefits may reduce incentives to search for work. This concern is far less relevant in Latin America and the Caribbean, where benefit levels and coverage remain limited. Moreover, noncontributory social protection systems in the region are largely delinked from ALMPs: cash transfer beneficiaries are rarely required to engage with PES or participate in ALMPs. As a result, ALMPs in Latin America and the Caribbean are generally not embedded within broader social protection systems, unlike in much of Europe (Nunn 2024).

ALMP implementation in Latin America and the Caribbean is also characterized by a proliferation of programs and limited coordination across government entities at both national and subnational levels (Nunn 2024). In Colombia, for example, more than 30 ALMP-related programs are delivered by national government agencies alone, including the ministries of trade, social prosperity, and labor. This number would at least double if locally funded initiatives were included (González-Velosa 2021). Most ALMPs focus on training programs for young people or other job seekers at the margins of the labor market, sometimes combined with employment incentives and intermediation, and often centered on relatively intensive work-based training components.

One explanation for the prevalence of ALMPs is their political appeal. They allow governments to signal commitment to improving employment outcomes, a highly salient public concern, through interventions with visible and easily measurable outputs, such as the number of individuals trained. ALMPs are also typically easier to implement than more complex and politically sensitive reforms, such as changes to labor market regulations (Carranza and McKenzie 2023).

In principle, PES, which are common across the region, could play a crucial role in overcoming this fragmentation, acting as a one-stop shop. They could connect registered job seekers with support services that implement ALMPs. However, their role in coordinating ALMPs is generally limited (ILO 2023). Service integration remains a challenge: according to the second edition of *The World of Public Employment Services* (IDB, OECD, and WAPES 2026), only 37 percent of PES worldwide had any role in unemployment benefit or insurance schemes, and far fewer, 17 percent, had any role in social assistance. In Latin America and the Caribbean, only two out of 16 PES agencies surveyed in 2024 combined PES delivery with responsibility for passive measures (such as unemployment benefits) or labor migration. This is a key opportunity for reform and modernization in the years ahead.

Their institutional setup, which varies significantly across countries, affects their ability to effectively integrate ALMPs. In countries such as Colombia and Costa Rica, PES operate through a network of public, private, and nonprofit providers coordinated by a central agency that sets standards and protocols. In Colombia, for example, the Network of Public Employment Service Providers includes various actors regulated by the public authority, with both national and local governments directly providing services alongside private providers. All participants must meet the network's standards. In contrast, countries such as Peru rely on PES units within labor ministries without budgetary autonomy. This setup presents challenges, as the ministries' inspection role can strain relationships with employers (Nunn 2024).

6.5.2 The Effectiveness of Active Labor Market Policies

ALMPs are among the most extensively studied social policy interventions worldwide. The accumulated evidence increasingly shows that, when well designed and effectively implemented, ALMPs can constitute sound and sustainable public investments. A recent review by the International Labour Organization (ILO) and the World Bank (2022) finds that three out of four impact evaluations of ALMPs in developing countries report benefits that exceed costs over the longer term, underscoring their potential to generate durable economic and social returns.

At the same time, ALMPs are inherently complex interventions. Their effectiveness depends on multiple factors, including program design, economic and labor market conditions, and delivery features. However, this complexity also underscores their flexibility: they can be adapted to different contexts, target populations, and policy objectives. The accumulated evidence increasingly allows for more nuanced conclusions by type of intervention, helping policymakers design more effective programs grounded in rigorous evaluation. Findings by type of intervention can be summarized as follows.

Three out of four impact evaluations of active labor market policies in developing countries report benefits that exceed their costs over the longer term.

Intermediation. Systematic reviews of experimental studies in developing countries show that traditional labor market intermediation services—such as public placement services, job-search assistance, résumé and interview preparation, job fairs, and vacancy information—tend to have small and short-lived effects. Estimated impacts typically range between 1 and 2 percentage points in overall employment and about 0.25 percentage point in formal employment. Evidence consistently suggests that impacts vary substantially with program design and targeting (McKenzie 2017; Card, Kluve, and Weber 2018; Novella and Valencia 2022; Espejo et al. 2023; Nunn 2024).

More recent evidence shows that these tools are more effective when they address information gaps on both sides of the market. On the worker side, mentoring and wage information reduced reservation wages and raised earnings by 18 percent in Uganda (Alfonsi, Namubiru, and Spaziani 2024), with similar results from job coaching in Switzerland (Arni 2015); even employed workers underestimate external wages and adjust behavior when informed (Jäger et al. 2024; Cullen 2024). On the employer side, credential signaling raises employment and earnings in Ethiopia, South Africa, and Uganda (Abebe et al. 2021; Carranza et al. 2022; Bassi and Nansamba 2022); skills certification for Colombian graduates yields wage gains of 7 to 10 percent concentrated among graduates from lower-reputation schools (Busso, Montaña, and Muñoz-Morales 2025); and reducing vacancy costs improves match quality in France and South Africa (Algan, Crépon, and Glover 2020; Abel, Burger, and Piraino 2020). Firms also systematically underprice vacancies: a 10 percent wage increase would raise fill rates by about 30 percent, yet many firms fail to adjust even with unfilled positions (Cullen, Hoffman, and Koenig 2025), and vacancy duration in the United Kingdom falls by 30 to 50 percent with a 10 percent wage increase (Bassier, Manning, and Petrongolo 2025). This

evidence suggests that ALMPs should expand their target population beyond unemployed job seekers to include employed workers who cannot observe outside opportunities and firms that need guidance setting wages—all contributors to inefficient matching and skills mismatch.

Training. Training interventions generally consist of short courses lasting three to six months. A recent meta-analysis of randomized experiments in developing countries finds that such programs increase participants' incomes by an average of 11 percent and raise the probability of employment by about 5 percentage points (Agarwal and Mani 2024). The largest and most robust effects are associated with classroom-based vocational training, while no significant impacts are found for apprenticeships. In Latin America and the Caribbean, a meta-analytic review of more than 40 retraining programs found positive average effects on wages and the probability of employment among unemployed workers, with better results when retraining programs provide technical skills, combine classroom and on-the-job training, and involve the private sector (Busso et al. 2022).

Average impacts in training mask large heterogeneities between programs and within different populations of the same training program. First, the effects might be larger for certain subsets of more vulnerable individuals. For example, in Colombia, Attanasio, Kugler, and Meghir (2011) find a 20 percent increase in earnings for disadvantaged young women compared with 7 percent for men, 14 months after training. In the Dominican Republic, job training had vastly different outcomes in personal skills acquisition and expectations for men and women (Acevedo et al. 2020). Second, evidence shows that the labor market context matters. However, training can have mixed employment effects when it is not well aligned with actual job opportunities. For example, in the Dominican Republic, the same program led to negative employment effects among male participants 3.5 years after training, possibly because it narrowed participants' job search to the trained sector and raised reservation wages (Acevedo et al. 2020).

Certification. Systematic evaluations of skills certification programs remain limited, but emerging evidence suggests that interventions that certify and credibly signal workers' skills can improve employment outcomes by reducing information frictions in hiring. Experimental evidence from low- and middle-income countries indicates that such programs can increase overall employment by about 2 to 6 percentage points and raise earnings by roughly 5 to 15 percent. Overall, the growing evidence points to promising results for ALMPs that go beyond standard placement services, particularly those that strengthen skills signaling in the labor market (Carranza and McKenzie 2024; J-PAL 2024).

Employment Subsidies. Systematic reviews suggest that employment subsidies tend to produce limited impacts on net job creation and wage increases, with mostly short-run employment gains that fade when the subsidy ends (McKenzie 2017; Card, Kluve, and Weber 2018; Ibarrarán et al. 2019). Most studies find short-term employment effects, but this policy has key risks. First, subsidies may fund hires that would have occurred anyway, resulting in deadweight loss. Second, they may cause subsidized workers to simply replace noneligible ones, resulting in substitution effects (Crépon et al. 2013; Brown 2015; Algan, Crépon, and Glover 2020). However, employment subsidies can still be useful to prevent job scarring during economic downturns (Ibarrarán et al. 2019; Bruhn 2020). There is also increasing evidence that wage subsidies may have the ability to shape who gets hired, especially if the subsidies are explicitly linked to job openings through matching or screening (Bussolo et al. 2025; Abel et al. 2022).

Public Works Programs. A meta-analysis by Bagga et al. (2026) concludes that public works programs can have short-term positive effects on wages and employment,⁵⁰ but these effects tend to fade in the medium run—more slowly when they generate large impacts on savings or investments in self-employment. Gehrke and Hartwig (2018) compare their effectiveness with that of poverty-reduction programs and conclude that public works programs are preferable to other interventions to reduce poverty, such as cash transfers, only if (a) they generate substantial investments among the target group; (b) private sector wages are below equilibrium wages; or (c) the public infrastructure generated has substantial growth effects.

6.5.3 Improving the Effectiveness of Active Labor Market Policies

Systematic reviews and meta-analyses have also examined the determinants of ALMP effectiveness. Overall, features such as program duration, the use of monetary incentives, individualized follow-up, and targeted participation are consistently identified as key drivers of impact (Escudero et al. 2017; Kluve et al. 2019; Levy Yeyati et al. 2025).

Importantly, this body of evidence also highlights specific design conditions that increase the likelihood that interventions generate positive impacts, underscoring the central role of program design in shaping effectiveness.

- A key factor in the effectiveness of ALMPs is their focus on training for expanding industries. This not only increases employment opportunities but also helps individuals enter sectors with sustained demand and long-term growth potential. This is the case with sectoral

⁵⁰. However, they estimate that for every 100 individuals taking a job, 75 would have worked in the absence of the program.

programs. In the United States, sectoral employment programs that targeted occupations with strong labor demand and opportunities for career advancement led to increased earnings and placed trainees in high-paying jobs (Katz et al. 2020).

- The payment structure for training providers is also crucial. Meta-analyses have found that programs that incentivize providers through results-based financing are more effective at achieving their goals (Kluve et al. 2019). Experimental evidence from Colombia, where training centers have been incentivized with payments contingent on securing jobs for their trainees, also supports this approach (Attanasio, Kugler, and Meghir 2011; Gómez and González-Velosa 2023).
- Evidence also offers clear guidelines on how the content and delivery of training programs should be structured to increase the effectiveness of ALMPs. Studies from Bangladesh, Uganda, Egypt, and the Dominican Republic highlight the benefits of incorporating on-the-job training and soft skills development. Combining practical experience with classroom-based training, as well as investing in soft skills such as communication, teamwork, and assertiveness, can enhance employability (Cavalcanti et al. 2023).
- Providing job seekers with accurate and timely labor market information is another key factor in improving the effectiveness of ALMPs. Recent studies show that it can help job seekers adjust their expectations and align their reservation wages more closely with reality. Evidence from Germany, South Africa, Ethiopia, and the Philippines shows that expanding access to job vacancy information and providing job search advice can lead to higher earnings (Cavalcanti et al. 2023). Importantly, misinformation among employed individuals also plays a significant role. Jäger et al. (2024) found that employed individuals in Germany often have inaccurate beliefs about their labor market opportunities, which can affect how they search for new jobs or negotiate better conditions in their current roles.
- One area that is highly underdeveloped in the region but holds significant potential according to the evidence is the provision of services to employers in hiring and recruitment. ALMPs focus primarily on supporting job seekers, particularly the most vulnerable, with employer-oriented services remaining underdeveloped and underutilized. However, evidence from France demonstrates that PES can help small and medium-sized firms by supporting their recruitment processes, including prescreening candidates and assisting in the design of job vacancies. This approach has been shown to increase vacancy postings (Algan, Crépon, and Glover 2020). Moreover, evidence also shows that employers struggle to set wages effectively. A firm-side randomized controlled trial (RCT) shows that firms have strong underlying demand for marketplace intermediaries to guide wage adjustment for unfilled jobs (Cullen, Hoffman, and Koenig 2025).

Overall, the evidence shows that ALMPs can improve employment and earnings outcomes, but their effectiveness is far from automatic. Impacts vary widely across intervention types, target groups, and economic contexts, and average effects often mask substantial heterogeneity. At the same time, limited cost-benefit evidence, risks of displacement, and weak integration with broader social protection systems highlight the importance of careful design and coordination.

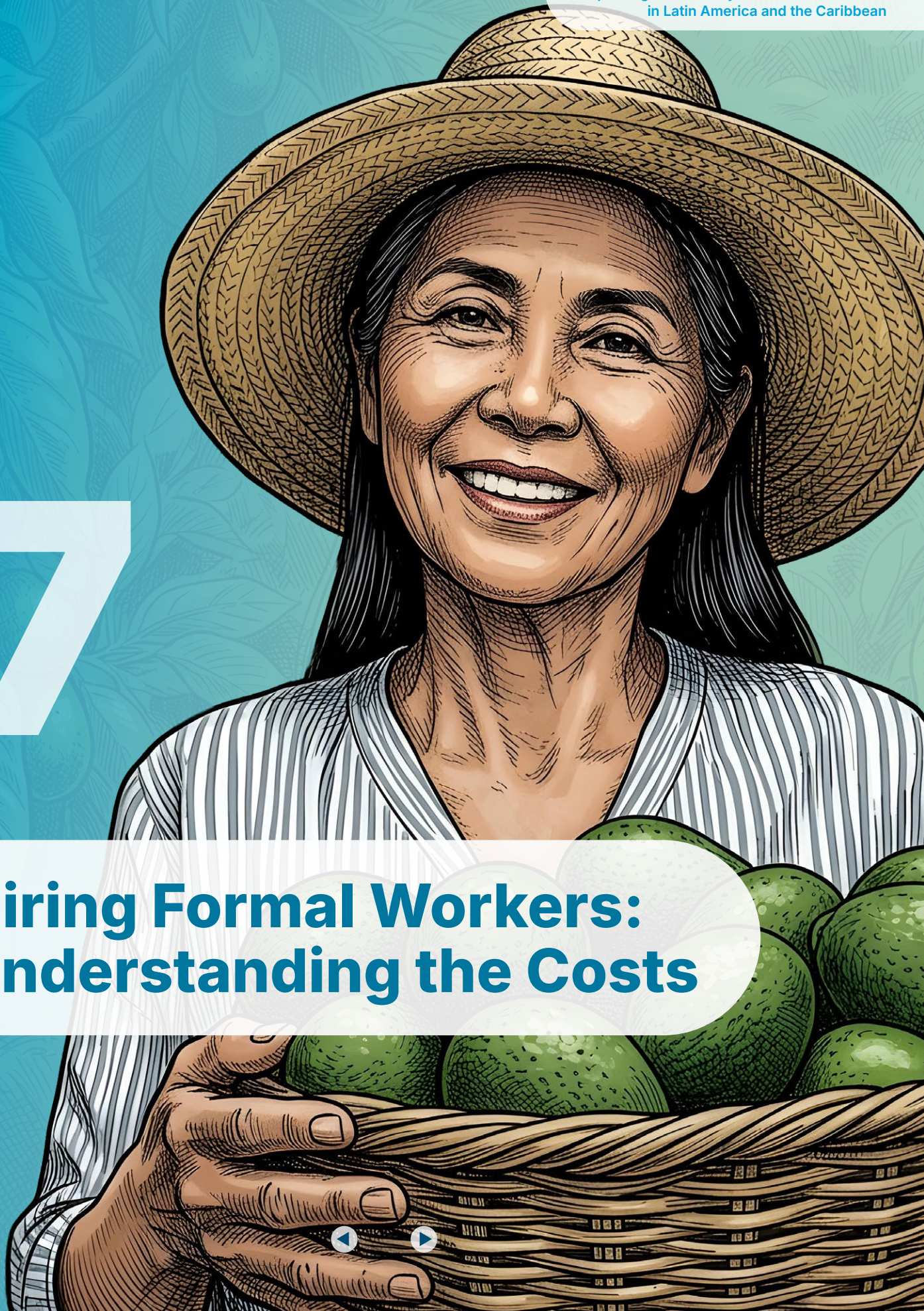
Fortunately, the large body of experimental and quasi-experimental evidence offers increasingly clear guidance on what works: targeting expanding sectors, incentivizing providers based on results, combining technical and soft skills with work-based learning, improving labor market information, and strengthening employer services. These insights inform our recommendations in Chapter 8.

The evidence offers increasingly clear guidance on what works: target expanding sectors, pay providers for results, combine technical and soft skills with work-based learning, improve labor market information, and strengthen employer services.



7

Hiring Formal Workers: Understanding the Costs



THIS CHAPTER IN FIVE POINTS

1 While there is substantial variation across countries, the region's labor costs are high by international standards. The legally mandated costs of hiring formal workers—combining payroll contributions and regulatory requirements—average 51 percent of wages in the region, about 9 percentage points above the non-LAC OECD average, and up slightly from 50 percent a decade ago. There is, however, significant heterogeneity, with Caribbean countries exhibiting substantially lower levels and Southern Cone countries higher ones.

2 Not all nonwage labor costs are equal: some are highly valued by workers or protect them against shocks, but others act as taxes. Many nonwage costs either finance poorly valued benefits, duplicate existing protections, or subsidize others, effectively functioning as a tax on formal employment.

3 Minimum labor costs are high relative to productivity levels, although there is substantial cross-country variation. In five countries, the minimum cost of hiring a formal salaried worker (which includes minimum wages, mandatory contributions, and other nonwage costs) exceeds 50 percent of GDP per worker. Moreover, additional measures of the cost of formalizing informal workers suggest that, in many countries, transitioning from informal to formal employment requires large increases in both wage and nonwage costs, amounting to more than 80 percent of the average informal wage.

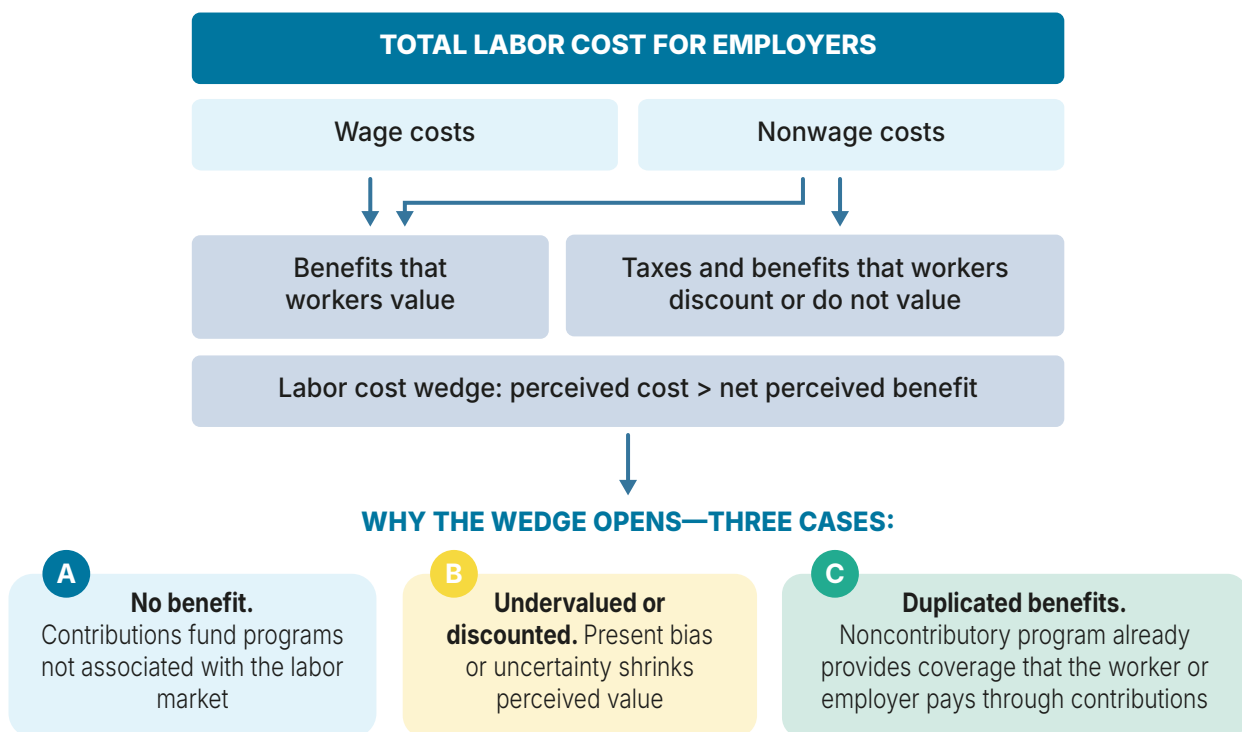
4 Evidence shows that changes in labor costs affect either wages or employment, and the dominant margin depends on the institutional context. In advanced and more formal economies, adjustments tend to pass through largely to wages, while suggestive evidence for the region indicates stronger effects on employment. This implies that labor cost reforms can lead to very different outcomes across countries, shaping whether adjustments materialize primarily through wages or through formal employment.

5 When formal labor costs are high relative to the cost of capital, firms may shift toward automation driven by distorted incentives rather than productivity gains. This risk is greater in contexts where capital is lightly taxed or subsidized, and is particularly relevant amid rapid technological change and advances in artificial intelligence that can displace workers across a wide range of tasks. In the region, this dynamic may lead to inefficiently fast automation and job displacement that reflects relative price distortions rather than underlying productivity improvements.

7.1 When Labor Costs Become a Tax on Formality

If one is serious about the goal of promoting formal employment, a natural place to start is to look at the total labor costs incurred by an employer to hire a worker in the formal sector. These costs include direct wages and all mandatory and indirect costs associated with complying with labor regulations and social security requirements. They can become a tax on formality when the additional costs of hiring a worker formally, relative to hiring a worker informally, are not perceived by workers as generating corresponding benefits. This arises when incurring these costs (a) does not provide direct benefits to the worker, (b) provides benefits that are not valued, or (c) provides benefits that the worker can access through other channels even without a formal job.

FIGURE 7.1 THE LABOR COST WEDGE: WHY WORKERS MAY NOT VALUE WHAT EMPLOYERS PAY



Source: Authors' elaboration.

The first case arises when contributions finance services that benefit other workers or individuals rather than the contributing worker. An example is the use of payroll taxes to finance social pensions for informal workers. The second case occurs when contributions provide

benefits for workers, but workers undervalue them. For instance, because of short-term thinking, workers may undervalue future benefits, such as old-age pensions, compared with receiving the same value in current wages. This also affects severance payments: uncertainty and litigation costs associated with disputes reduce the likelihood that workers will actually receive them. The third case arises when payroll contributions finance benefits that are also provided through noncontributory programs. For example, Mexico's Seguro Popular, which provided free health coverage for informal workers, reduced Mexican Social Security Institute (IMSS) formal registrations by 4 percent in smaller firms (Bosch and Campos-Vázquez 2014). Importantly, labor costs that have these three characteristics can reduce formal employment regardless of whether monopsony power exists.

Changes in labor costs also alter the relative price of labor with respect to capital. In this context, when formal labor costs are high relative to the cost of capital, firms may adjust not only by shifting toward informality but also by increasing capital intensity, adopting automation, or introducing technologies that reduce reliance on formal labor. Evidence on these substitution effects remains limited in Latin America, although relevant work exists for the United States (Acemoglu, Manera, and Restrepo 2020).

This margin is particularly important in the current context of rapid technological adoption and advances in artificial intelligence, which can displace workers across a range of tasks. These job dislocations could be amplified if labor is heavily taxed while capital is lightly taxed or even subsidized. This would lead to a problematic scenario in which firms accelerate automation and displace workers not primarily in response to productivity gains, but as a result of relative price distortions between labor and capital.

7.2 Adding It Up: The Weight of Nonwage Labor Costs

We begin by presenting data on the nonwage costs associated with formal employment. These costs have remained relatively stable over the last decade, at levels that are high by international standards. Alaimo, Altamirano, and Minaya (2026) provide a comprehensive assessment, measuring nonwage costs as social security and other mandatory employer–employee contributions, as well as additional labor regulation costs, such as severance payments and dismissal notifications, across 19 countries in 2013 and 2023. It is incorrect to classify all these costs as pure taxes on formality because some of them finance benefits that are highly valuable to workers and are, in essence, part of their compensation

package. However, many of these contributions fund programs with the characteristics of pure taxes on formality, either because they duplicate existing noncontributory programs, benefit other workers, or provide benefits that formal workers severely undervalue.

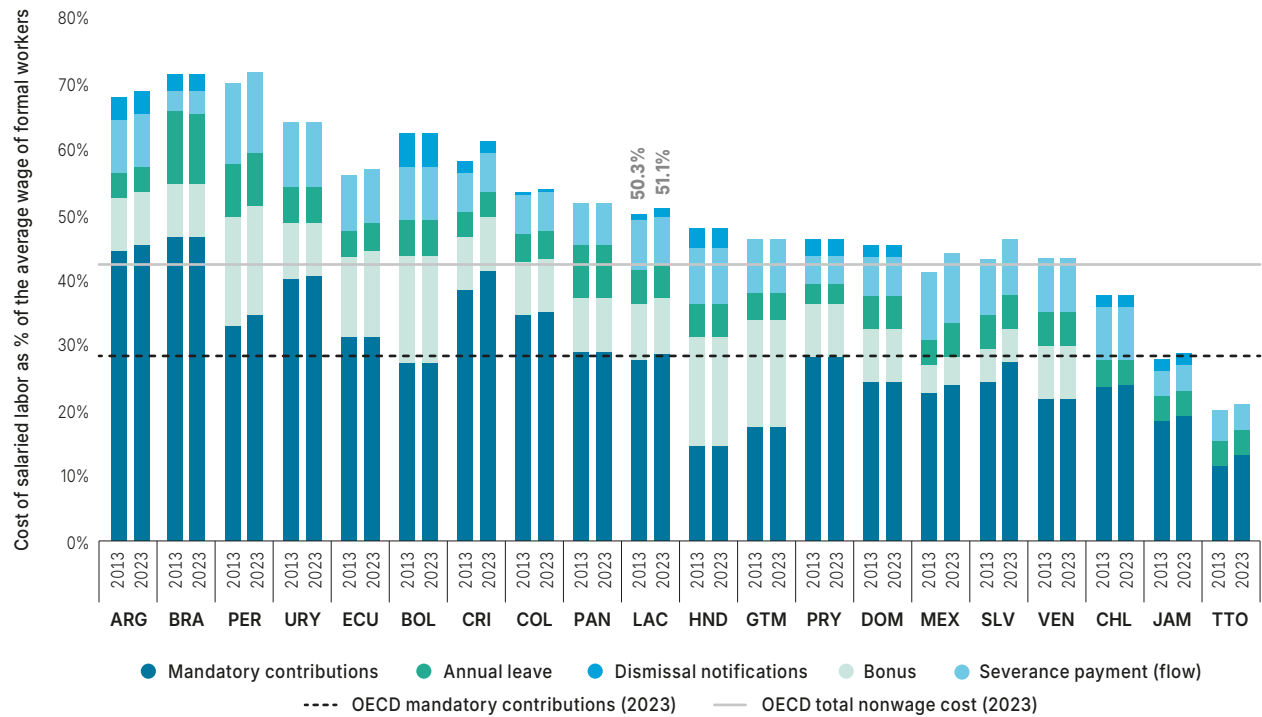
Nonwage costs of hiring formal employees in Latin America and the Caribbean average 51.1 percent of formal wages, a slight increase from 50.3 percent in 2013 (Figure 7.2). Applying the same methodology as Alaimo, Altamirano, and Minaya (2026) to OECD countries outside Latin America and the Caribbean (non-LAC OECD countries), we estimate that nonwage costs reached 41.7 percent of average wages in 2023, 9.4 percentage points below the average for Latin America and the Caribbean. The divergence in total cost is primarily driven by job security provisions and annual bonus payments. Severance pay exists in most OECD countries, but at lower levels because of the existence of unemployment benefits, as detailed in Chapter 4. Annual bonuses, also called 13th- or 14th-month salary payments, are common but rarely statutory in non-LAC OECD countries.⁵¹ Dismissal notifications are the one component for which non-LAC OECD costs exceed those in the region. On average, they constitute 2.7 percent of the average wage, more than double the 1.2 percent average for Latin America and the Caribbean. Mandatory paid leave is broadly similar between Latin America and the Caribbean and the non-LAC OECD, at approximately 5.3 percent of the average wage in both cases.

Not only are nonwage costs of hiring formal employees high in many countries, but there is also no clear trend toward decreasing costs over time. No country in the sample has experienced a reduction in total nonwage labor costs, while these costs have increased in 9 out of 19 countries. Recent pension reforms suggest that nonwage costs in the region are likely to rise further. For example, Mexico approved a gradual increase in the pension contribution rate from 6.5 percent in 2021 to 15 percent by 2030; Chile's rate will rise from 10 percent in 2025 to 17 percent in 2029; and Panama approved a 3-percentage-point increase in 2025.

No country in the region has reduced total nonwage labor costs in the past decade—and in 9 of 19, they have risen.

⁵¹. Where they exist, they typically arise from collective bargaining agreements.

FIGURE 7.2 AVERAGE NONWAGE COST OF SALARIED LABOR
IN LATIN AMERICA AND THE CARIBBEAN



Source: Alaimo, Altamirano, and Minaya (2026).

Note: The OECD mandatory contribution and total nonwage cost estimates are constructed using the same methodology as in Alaimo, Altamirano, and Minaya (2026) using data from OECD (2023) and World Development Indicators (WDI) for OECD countries excluding Chile, Colombia, Costa Rica, and Mexico.

Based on these results, it is reasonable to question whether reducing informality has been a sufficiently high policy priority in the region. A key way to promote formal and productive employment is to reduce the cost of formality. With few exceptions, the region has not used fiscal resources for this purpose. If reducing informality is a priority, policymakers should shift part of what is financed through payroll contributions levied on formal workers and employers toward general tax revenue.

BOX 7.1 FINANCING RECENT REDUCTIONS IN SOCIAL SECURITY CONTRIBUTIONS

Countries that have recently reduced contribution rates have relied on a variety of mechanisms to offset the fiscal cost. For example, in Norway, cuts in social security contribution rates for low- and medium-income households were financed by effectively increasing contributions for high-income households. In Finland and the United Kingdom, recent rate reductions were financed through increases in personal income taxes via indexation.

FINANCING RECENT SOCIAL SECURITY CUTS IN SELECTED EUROPEAN COUNTRIES		
Country, year	Policy	Alternative financing
Norway, 2024	Cuts to employee social security contribution (SSC) rates, effectively lowering the tax wedge for low- and medium-income households.	Decrease in the top three bracket thresholds and increase in their rates to offset the revenue decrease.
Finland, 2024	Reduction in unemployment insurance and health contributions by 0.2 percentage points.	Reduction in health benefits financed through payroll taxes and increase in personal income taxes through indexation.
United Kingdom, 2024	Reduction in National Insurance contributions from 10 to 8 percent, in addition to further cuts to the main rate for the self-employed.	Increases in the tax base through indexation.

What Does the European Experience Mean for Latin America and the Caribbean?

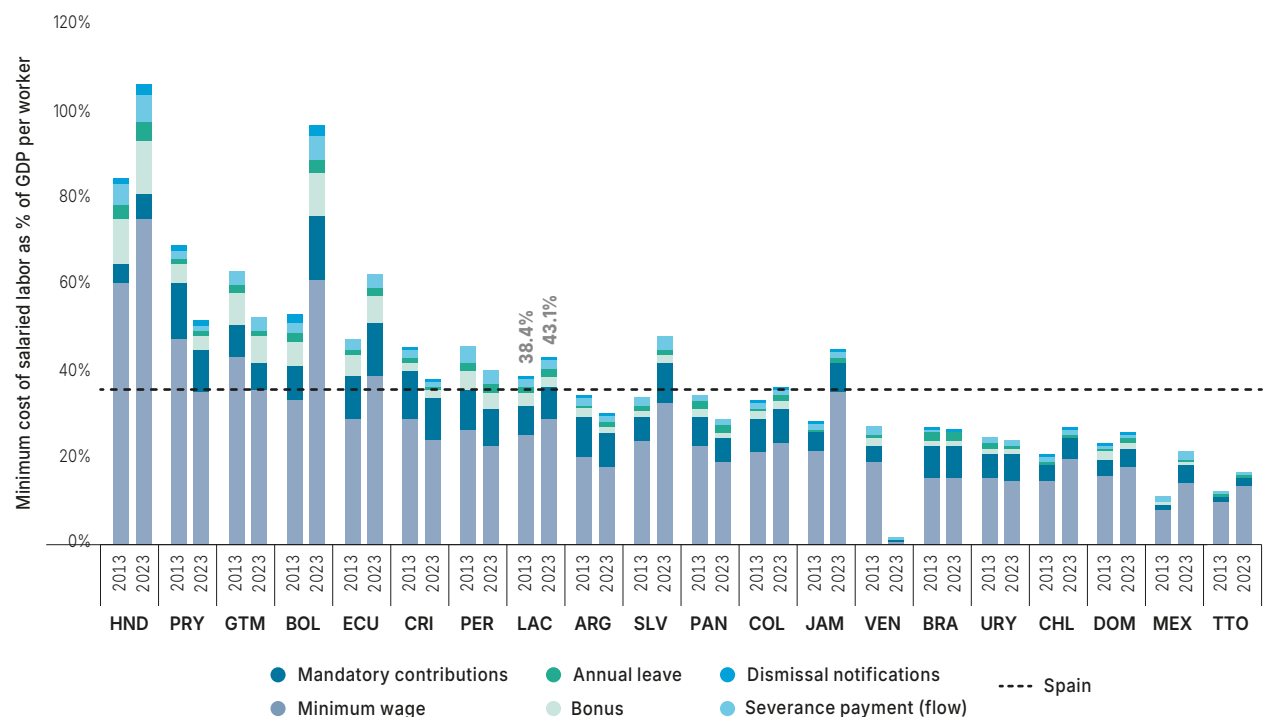
The experience of Europe can offer useful insights for the region. Studies from developed countries show that lowering payroll taxes has small effects on employment overall but can have a larger impact when targeted at specific groups. This has shaped how labor reforms have been applied in the European Union. For example, a French study analyzing a large payroll tax cut specifically for minimum-wage workers found a 13-percentage-point increase in employment at that wage level, indicating that targeted SSC relief can be effective in contexts with binding minimum wages (Cottet 2024). In a region where wages are often rigid and minimum wages are high, cutting payroll taxes might be an effective tool, especially if focused on groups more likely to work informally and on cash-constrained firms. However, shifting the financing of social protection from payroll taxes to other types of taxes can place a disproportionate burden on lower-income workers, so tax reform needs to be carried out carefully.

7.3 Beyond the Wage: The Minimum Cost of Hiring Workers

The calculations thus far have excluded one of the most important elements of labor regulation: the minimum wage, which warrants close attention. We incorporate it by calculating the minimum cost of hiring formal wage workers, which includes not only the minimum wage itself, but also mandatory employer payroll contributions and other nonwage costs associated with formal employment.

As shown in Figure 7.3, this cost, measured as a share of GDP per worker, increased on average from 38.4 percent in 2013 to 43.1 percent in 2023. For reference, the regional average is 6 percentage points above Spain (37 percent), which is the country with the highest nonwage labor cost in the OECD. In some countries, this added to an already high baseline cost of formal employment. The most extreme case is Honduras, where the minimum cost of hiring a formal wage employee rose from 84.2 to 106.0 percent of GDP per worker between 2013 and 2023. In Bolivia, Ecuador, Guatemala, and Paraguay, this cost exceeds 50 percent of GDP per worker.

FIGURE 7.3 MINIMUM COST OF SALARIED LABOR IN LATIN AMERICA AND THE CARIBBEAN AS A PERCENTAGE OF GDP PER WORKER



Source: Alaimo, Altamirano, and Minaya (2026).

In many countries, these costs are clearly excessive. In five countries, the minimum cost of hiring a formal salaried worker exceeds 50 percent of GDP per worker. This implies that any worker who generates less than 50 percent of average labor productivity will be excluded from formal salaried work, even assuming that all value added goes to workers. Since other factors of production will necessarily receive part of the value added generated, the minimum cost of formal salaried labor in these countries excludes large segments of workers from the possibility of obtaining a formal salaried job. While evidence shows that appropriately set minimum wages can sometimes raise earnings with minimal distortions, and that sound labor regulations play a crucial role in correcting market failures, firms will not hire workers if costs exceed the revenue they generate. As Chapter 8 discusses, levels so far removed from labor market realities are not only aspirational and infeasible but also exclusionary, effectively blocking most workers from formal employment and undermining the rule of law.

An additional calculation that helps explain the persistence of informality is the cost of formalizing informal workers. In practice, this cost varies across workers, firms, and institutional settings, but here we present a summary measure to facilitate comparison. To illustrate how it is calculated, Table 7.1 builds this indicator for Colombia in 2023.

TABLE 7.1 THE COST OF FORMALIZING INFORMAL LABOR IN COLOMBIA, 2023
(IN US\$ PPP AND AS A PERCENTAGE OF INFORMAL WORKERS' WAGES)

	VALUE	UNIT
Average annual wage of informal salaried workers	8,589	US\$ PPP
Annual minimum wage	9,934	US\$ PPP
Wage cost of hiring formally	1,345	US\$ PPP
Monetary value of mandatory contributions of a formal worker earning the minimum wage	3,312.8	US\$ PPP
Monetary value of job security provisions of a formal worker earning the minimum wage	639.6	US\$ PPP
Monetary value of bonus payments of a formal worker earning the minimum wage (<i>aguinaldo</i>)	816.5	US\$ PPP
Monetary value of paid leave of a formal worker earning the minimum wage	408	US\$ PPP
Total nonwage cost of formal employment	5,176.1	US\$ PPP
Nonwage cost of formal employment	60.3%	% of informal wages
Wage cost of formal employment	15.7%	% of informal wages
Total cost of hiring a formal employee as a percentage of informal wages	76%	% of informal wages

Source: Alaimo, Altamirano, and Minaya (2026).

Note: The monetary value of contributions and job security provisions is calculated over the base wage—the minimum wage plus, in the case of Colombia, bonus payments.

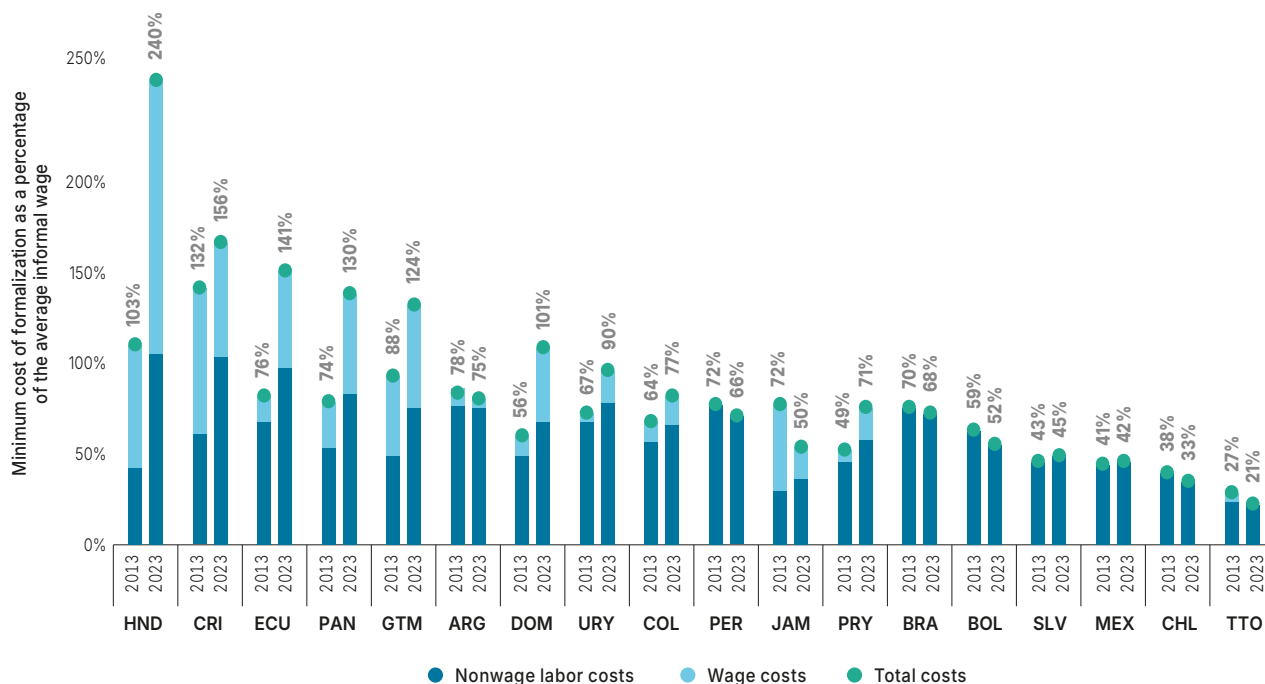
The first element we consider for the formalization of informal labor is what we refer to as the wage cost. Although in some countries the average informal worker earns above the minimum wage, on average for the region the minimum wage is 15.7 percent higher than the average informal wage. However, the nonwage costs of formalization—those that would have to be paid for a minimum-wage worker—are on average 60.3 percent of the average informal worker's wage.

Figure 7.4 presents this calculation separately for 18 countries. What is striking from this chart is the enormous variation. Figures for 2023 range from a low formalization cost of 21 percent of the average informal wage in Trinidad and Tobago to 240 percent in Honduras. But how should we interpret these results, especially in relation to the earlier findings on labor costs?

Take, for example, the case of Bolivia, which had the second-highest minimum cost of salaried labor in 2023, but a below-average cost of formalizing informal labor. That the average informal wage is above the minimum wage tells us that, for many informal workers, the minimum wage is not currently the binding constraint on formalization. This does not, however, imply that the minimum wage is not a problem. The fact that the minimum cost of hiring a formal salaried worker is nearly 100 percent of GDP per worker tells us that, for many workers, the minimum wage alone can put a formal salaried job out of reach. Although a successful formalization campaign can begin with comparatively high-wage workers in the informal sector, the formalization of lower-wage informal workers will likely require addressing the level of the minimum wage.

The cost of formalizing an informal worker ranges from 21 percent of the average informal wage in Trinidad and Tobago to 240 percent in Honduras.

FIGURE 7.4 THE MINIMUM COST OF FORMALIZING INFORMAL LABOR, 2013 AND 2023



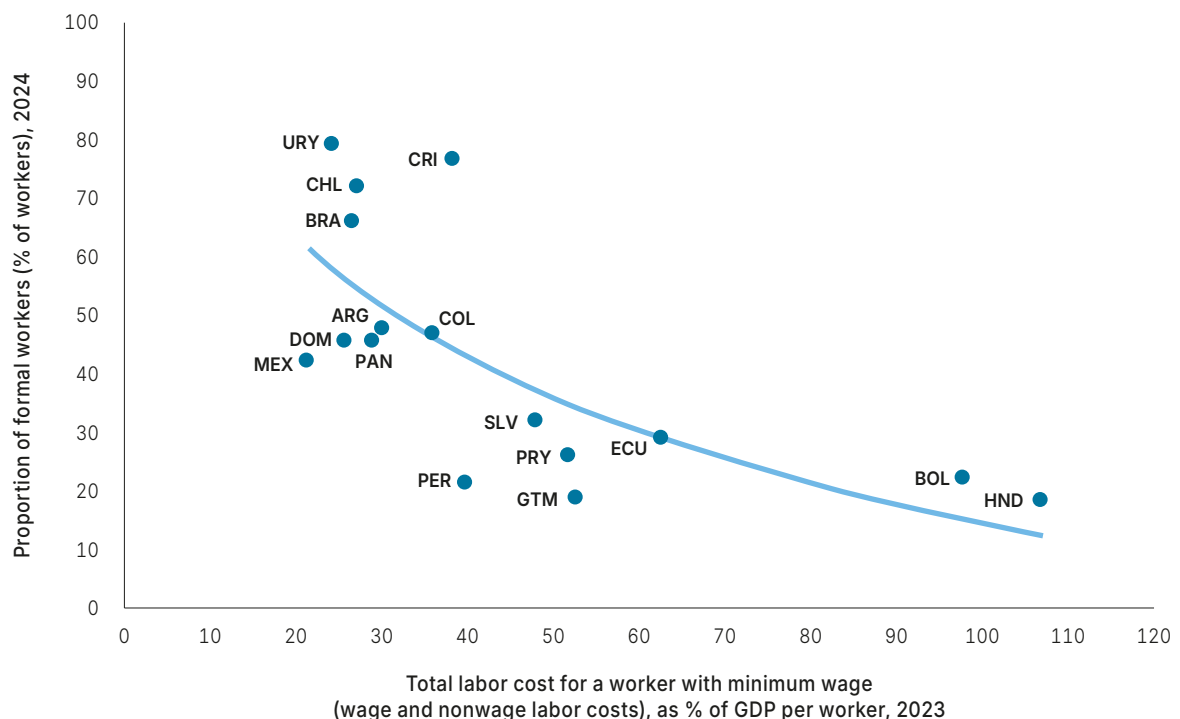
Source: Alaimo, Altamirano, and Minaya (2026).

The three measures of formal salaried labor costs can all be summarized simply. In many countries, the legally mandated costs of formal salaried work are excessive. The results also reveal, however, considerable differences across countries. In some countries, the main issue is nonwage costs. In other countries, the minimum wage appears to be a major problem that will need to be addressed. In a few cases, it is difficult to see how formal employment could be increased significantly in the short term without addressing the high level of the minimum wage. In other cases, despite existing space to formalize some informal workers without adjusting the minimum wage, it is likely that a sustained formalization process will eventually have to address this admittedly sensitive issue.

7.4 Rethinking Labor Costs to Boost Formality

The results presented on both wage and nonwage labor costs are important because the evidence shows that they affect labor outcomes. In general, countries with lower labor costs relative to GDP per worker, such as Uruguay, Costa Rica, Chile, and Brazil, have higher levels of labor formality, above 60 percent. In contrast, economies with higher labor costs, such as Honduras, report formality levels below 20 percent. The fitted curve suggests a nonlinear relationship, in which moderate increases in labor costs are associated with significant reductions in formality, while at very high cost levels the curve flattens. These results support the hypothesis that high labor costs act as a barrier to formalization, particularly in contexts with low productivity and productive structures dominated by microenterprises and persistent informality (Figure 7.5). In countries with costly formal employment regulations, informal hiring may become a survival strategy.

FIGURE 7.5 FORMAL EMPLOYMENT AND LABOR COSTS IN LATIN AMERICA AND THE CARIBBEAN (CIRCA 2023)



Source: Authors' calculations using data from IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean, and Alaimo, Altamirano, and Minaya (2026).

Note: Venezuela is excluded because the real value of the minimum wage is very low, which would obscure patterns across other countries.

This correlation, while informative, should not be interpreted as causal, since it may reflect the influence of underlying factors that simultaneously shape both labor costs and labor market outcomes. However, a large body of rigorous empirical evidence—using credible identification strategies—supports the view that labor costs do affect labor market outcomes. As discussed in Chapter 4, an extensive literature examines the effects of changes in labor costs through minimum wage adjustments. The evidence shows that the impact on wages and formal employment depends on the level of the increase and the characteristics of the labor market. There is also substantial evidence on the impact of nonwage labor costs. These studies find that reductions in payroll taxes and other contributions are typically absorbed either through higher net wages or through increased formal employment. Which margin of adjustment dominates depends on the institutional context, particularly the degree of labor market rigidity.

Evidence from OECD countries (Sweden, Norway, Finland, Canada, and Italy) finds that payroll tax reductions are often largely passed through to wages, with more limited impacts on employment. This pattern is consistent with a setting characterized by relatively rigid and formal labor markets, in which changes in labor costs are more likely to translate into workers' compensation than into employment. Studies for Chile and Argentina find that reductions in social security contributions are largely passed through to workers in the form of higher wages, with only modest effects on formal employment (Gruber 1997; Cruces, Galiani, and Kidyba 2010). In Colombia and Brazil, by contrast, adjustments appear to operate more strongly through employment. In Brazil, the partial elimination of payroll taxes generated sizable increases in employment, on the order of 12.8 percent, alongside some wage gains. In Colombia, evidence shows that payroll tax reductions increased formal employment by 3 to 5 percentage points and reduced informality by around 4 to 5 percentage points, particularly among micro and small firms, with relatively limited effects on wages (Betcherman, Daysal, and Pagés 2010; Bernal, Eslava, and Meléndez 2015; Steiner and Forero 2015; Kugler, Kugler, and Herrera Prada 2017).

TABLE 7.2 REVIEW OF EVIDENCE ON THE IMPACT OF LABOR COSTS ON LABOR MARKET OUTCOMES IN LATIN AMERICA AND THE CARIBBEAN

COUNTRY	REFORM CONTEXT	MAIN OUTCOME	EFFECT ON EMPLOYMENT (%)	EFFECT ON WAGES (%)
Argentina: 1995–2001 (Cruces, Galiani, and Kidyba 2010)	Reduction in geographically varying rates.	Salary changes equivalent to half the fiscal reduction, with no significant effects on formal employment. Fiscal revenue fell by nearly half.	0.5% among formal workers (nonsignificant coefficient)	-1%
Brazil: 2012 (Lobel 2024)	20% payroll tax reduction for a small subset of firms.	The tax reduction led to a 12.8% increase in employment three years after implementation, more pronounced in small firms. Wages increased by 3.1%.	12.8% (all firms); 34.6% (small firms); 9.7% (large firms)	3.1% (all firms); 6.0% (small firms); 2.3% (large firms)
Chile: 1990s (Gruber 1997)	Large reduction in contributions of 25%.	The reduction was fully passed on to wages, with no discernible impact on employment.	-0.1% (all workers; nonsignificant coefficient)	1.0% (all workers)
Colombia: 2012 (Antón 2014)	Reduction in payroll taxes by 13.5%.	Total employment increased by 0.3% and 0.5%, formal employment increased by 3.4% to 3.7%, and formal wage rates increased by 4.9%.	Scenario A: formal employment, 3.7%; Scenario B: formal employment, 3.4%	Scenario A: gross formal wage, -4.0%; net formal wage, 4.9%; gross informal wage, 2.9%; net informal wage, 3.0%; self-employed net earnings, 2.8%; employer net earnings, 4.0%
Colombia: 2012 (Bernal et al. 2017)	Reduction in payroll taxes and health insurance contributions by 13.5%, with an increase in corporate income taxes.	Positive average effect of 4.3% on formal employment and 2.7% on average firm wages.	4.3% (all firms); 3.7% (micro firms); 3.1% (small firms); -2.7% (medium and large firms)	2.7% (all firms); 2.2% (micro firms); 3.7% (small firms); 1.6% (medium and large firms)
Latin America and the Caribbean: 15 countries (Lora and Fajardo 2012)	Use of panel models to measure the effect of payroll tax increases on key labor market variables.	On average, each percentage-point increase in payroll taxes raises unemployment and informality, although the effects vary considerably by type of payroll tax, workers' education level, and institutional flexibility.	A 1 percentage-point increase in payroll taxes is associated with a 0.14 percentage-point decline in total employment.	2.1% (total wages); 1.8% (informal workers' wages)

Source: Authors' elaboration.

We have seen throughout this chapter that several measures of the legally mandated costs of hiring formal salaried labor are not only high in the region but also increasing as a general regional trend. Policies that tax formal employment end up subsidizing informal activities, allowing low-productivity firms to survive and preventing more productive firms from expanding, thereby reducing aggregate productivity (Busso, Fazio, and Levy 2012). The reader would be correct in assuming that we will therefore recommend several measures to limit these costs. The essence of our policy recommendations will be the guidance they provide on two issues. First, we will be clear about which labor costs should be reduced. Although many of our recommendations will translate into lower costs for firms, we will argue that some labor costs need to be maintained. Second, we will explain how labor costs can be controlled without undermining social protection and in a way that leads to higher levels of productivity.

Taxing formal employment ends up promoting informality—letting low-productivity firms survive and stopping more productive ones from expanding.



8



An Agenda for Labor Market Reform: Policy Recommendations



Labor policies are not the only determinant of long-run productivity and workers' welfare in Latin America and the Caribbean, but they are unquestionably central. With large shares of unprotected workers, widespread noncompliance, persistent distortions in the allocation of labor, and chronic underinvestment in skills across the life cycle, the region cannot realize its growth potential and cannot deliver the gains of growth to its people. These challenges will only intensify with rapid demographic change and the adoption of digital technologies and artificial intelligence that may dislocate workers. Without stronger, fairer, better-functioning labor markets, Latin America and the Caribbean cannot raise the productivity that sustainable growth requires and cannot ensure that workers share in the prosperity that growth produces.

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An agenda to make labor markets work is therefore essential. The chapter supports this effort and is structured in two parts. Section 8.1 presents five guiding principles that, regardless of the specific labor market context or policy choices, provide a foundational framework for labor policy design. Section 8.2 then turns to more detailed reform proposals and implementation pathways.

The chapter is written with a transformative ambition, and some recommendations are therefore structural and potentially disruptive. We do, however, recognize the political economy and fiscal constraints that can complicate their adoption. For this reason, the chapter combines structural reforms with more gradual steps, outlining a coherent and pragmatic reform agenda. Gradualism should not be mistaken for a lack of ambition: while implementation may take time, the objective is to achieve lasting improvements in productivity and workers' welfare.

The chapter is also written with implementation in mind. Rather than focusing only on what countries should do in terms of policy design, it also examines how labor policies can be implemented in practice. It draws on a wide range of country experiences from both within and outside the region. In some cases, it also examines reforms that fell short of expectations or failed to achieve their intended results, with the aim of helping policymakers avoid similar pitfalls.

While all readers are encouraged to engage with the recommendations, the level of detail reflects the needs of practitioners. When one purchases a piece of furniture that requires assembly, one hopes that the instruction manual is written as clearly as possible without eliminating essential details. The idea is not to entertain the reader with prose, but rather to offer clear guidance to a person who wants to put the pieces together in the correct fashion. Consider the description of the specific recommendations in this chapter partly as an assembly manual for transformative labor policies.

8.1 Five Principles to Guide Labor Policy Design

Before turning to specific recommendations, it is useful to keep in mind a set of core principles that capture essential features of labor policy. These are not context-specific prescriptions, but general guidelines that apply to any policy reform. Together, they help define what labor policy can realistically achieve and its limits, while providing a coherent framework for policy design that improves productivity and workers' welfare.

1. Labor Policy Inevitably Affects Both Productivity and Equity

Labor markets operate as a single system that simultaneously determines how labor income is distributed and how productively labor is used, so labor policy choices inevitably affect both productivity and equity. There is no such thing as a "purely redistributive" or "purely productivity-enhancing" labor policy. Interventions that seek to improve labor productivity by changing hiring incentives, contract regulations, dismissal conditions, or worker mobility will inevitably also reshape workers' compensation and job access, while policies that aim to increase equity by raising pay, strengthening skills, or increasing protection will simultaneously influence how labor is allocated and used. The key point is that labor policy cannot be assessed along a single dimension. Its effects on productivity and equity are inseparable, and policymakers must assess both dimensions jointly.

*There is no such thing as a
"purely redistributive" or "purely
productivity-enhancing"
labor policy.*

2. Worker Protection Is Not Limited to Job Stability

Historically, labor policy in Latin America and the Caribbean has emphasized job stability through employment protection legislation (EPL). While EPL is a core element of worker protection, effective worker protection design requires a broader approach that goes beyond stability in standard salaried employment; it must include income protection during unemployment and support for workers in transitions across occupations and sectors. This shift is essential for two reasons. First, a large share of employment in the region does not fit the traditional employer–employee model, leaving many workers in nonsalaried arrangements with limited protection against shocks. Second, when social protection systems effectively insure workers against income risks, support skills development, and provide incentives consistent with allocative efficiency, greater stability and higher wages can emerge endogenously as workers are better matched to jobs and become more productive.

3. Labor Regulations Can Reduce Inequality, but Other Tools Are Often More Effective

Labor regulations can play an important role in shaping inequality through their effects on labor income—the main source of earnings for most households—and through job protection. However, their reach is limited, as many are designed to protect only salaried workers. Moreover, if these regulations are too stringent, they can have unintended consequences, including reducing demand for formal jobs and creating barriers to formal employment expansion. As a result, they are often not the most effective instrument for reducing inequality. Instead, broader fiscal and social policies may have a stronger impact. For instance, redistributive taxation and transfers directly compress income differences, while education and skills policies address the structural sources of inequality by improving access to better-quality jobs and raising productivity.

4. In Monopsonistic Labor Markets, Labor Policy Can Go Beyond Raising Workers' Compensation and Directly Increase Competition

Limited labor market competition allows some employers to pay wages below workers' marginal productivity, and minimum wages and collectively negotiated wage agreements can help correct these wage markdowns by raising workers' pay and increasing benefits. However, other labor policy tools can effectively improve workers' compensation by strengthening labor market competition itself—by making it easier for workers to move between jobs and improving the information they have about alternative opportunities. These include, among others, investments in general and transferable skills that increase worker

mobility, stronger support for workers during job transitions through unemployment insurance and employment services, and better information about available job opportunities and wages through job-matching platforms. Similarly, any policy that promotes a large mass of productive firms competing for workers can decrease monopsony power through increased competition. These mechanisms are often underemphasized in policy design, despite their potential to play a central role in strengthening labor market competition and improving outcomes.

5. Labor Policy Is Fundamentally Social and Political

Labor markets allocate the economy's main factor of production—labor—and determine the primary source of household income. Yet they are more than economic mechanisms; they are core social institutions. People spend a large share of their lives at work, where they not only earn a living but also derive identity and agency. Job loss, when experienced at a large scale, is not merely an economic shock, but a profound social disruption that can sometimes have far-reaching political consequences. Labor markets are also a key arena for enforcing protections against discrimination and labor abuse. Labor policy must be built on this premise—recognizing that labor markets are not only economic mechanisms but also key social and political institutions that play a central role in preserving social inclusion, cohesion, and institutional trust.

Labor markets are not only economic mechanisms but also key social and political institutions that play a central role in preserving social inclusion, cohesion, and institutional trust.

8.2 Policy Recommendations

This section presents policy recommendations organized around three pillars of labor policy: (i) modernizing employment regulation and social protection systems, (ii) strengthening labor institutions and enforcement, and (iii) developing workforce skills and expanding job access. Within these pillars, specific recommendations are outlined across nine strategic areas, as summarized in Table 8.1.

TABLE 8.1 POLICY RECOMMENDATIONS IN THREE PILLARS AND NINE STRATEGIC AREAS

PILLAR	SECTION	STRATEGIC AREA
8.2.1 Modernizing Employment Regulation and Social Protection Systems	A	Regulating Contracts
	B	Dismissal Procedures and Unemployment Protection
	C	Protecting Income for All
	D	Minimum Wage Policy
	E	Revitalizing Collective Bargaining
8.2.2 From Rules to Enforcement: Building Credible Labor Institutions	A	Effective Enforcement
	B	Enhancing Labor Justice
8.2.3 Developing Workforce Skills and Expanding Job Access	A	TVET Reform
	B	Active Labor Market Policies

Source: Authors' elaboration.

8.2.1 Modernizing Employment Regulation and Social Protection Systems

A) Regulating Contracts: Promoting Fair Treatment in a Diverse Labor Market

As discussed in Chapter 4, regulating the use of different contract types is a core concern in modern labor legislation. Contract rules are essential to protect workers in inherently asymmetrical relationships, especially those with limited bargaining power. They also shape productivity by influencing firms' incentives to hire and invest in workforce development. The recommendations that follow focus on structuring contractual arrangements to reflect the nature of work, limit misuse, and support both efficiency and equity.

Legislation should recognize that diversity in work arrangements calls for a corresponding diversity of contract types. In practice, labor relations vary widely depending on the nature of the work and the needs of both employers and employees. Labor regulations should therefore accommodate a range of contractual modalities. Fixed-term contracts, for example, are often essential when employment is temporary, such as during demand fluctuations, to replace a worker on leave, or to evaluate a worker before offering an open-ended position.

Offering a well-defined menu of contractual options, together with clear and transparent rules governing their use, is essential to accommodate heterogeneity in labor relations while limiting uncertainty. Mexico's 2012 labor reform provides a useful example. The reform introduced two fixed-term contracts with narrowly specified purposes: the *contrato a prueba* [trial contract] and the *contrato de capacitación inicial* [initial training contract]. These instruments were designed to help young workers overcome the "experience trap," whereby lack of experience prevents labor market entry and limited job opportunities impede skill acquisition. Importantly, the reform set strict limits on the duration of these contracts and prohibited their indefinite renewal. By clearly defining their scope and safeguards, the reform expanded early employment opportunities while curbing the risk of misuse (Arellano Cuan, Ortega González, and Tuero Fricke 2013; OECD 2015).

The classification of platform workers as employees or independent workers should be guided by the characteristics of the job—its tasks, responsibilities, rights, and degree of autonomy—rather than by the mere fact that the work is performed through a digital platform.

Legislation should promote regulatory neutrality, promoting parity in benefits and protections across contract types, allowing deviations only when they are clearly justified by the nature of the work. For example, when the key difference between two workers is that one performs tasks expected to continue indefinitely while the other performs tasks needed only for a limited period, it is reasonable to use a temporary contract for the latter to reflect the anticipated end of the employment relationship. However, there is no clear rationale for treating apprentices or temporary workers differently from other workers with basic protections such as, for example, maternity benefits or occupational safety. Any differences in treatment should be strictly limited to those justified by the nature of the work arrangement itself.

This principle of regulatory neutrality matters not only because it is fairer, but also because it reduces incentives to misuse contracts. Large and unjustified cost differentials across contract types often lead employers to

favor lower-cost, less secure arrangements, even when these do not reflect the true nature of the labor relation. Employers may even have incentives to circumvent regulations in contracts that are often beyond the effective reach of enforcement agencies, thereby undermining compliance and, ultimately, the rule of law.

Several examples illustrate how countries have taken steps to equalize conditions between contracts in dimensions that are not intrinsically tied to the duration of the employment relationship. In Argentina, for example—where, as discussed in Chapter 2, permanent contracts account for a large share of employment—the social security system explicitly covers all workers providing services within the national territory, regardless of whether their contracts are permanent or temporary. Equal treatment in access to unionization is also central: under Argentine law, temporary workers enjoy the right to union representation and participation in collective bargaining. Chile provides another example through its unemployment insurance system, which covers workers under both open-ended and fixed-term contracts. Beyond the region, reforms implemented in 2013 in Slovenia and Portugal sought to reduce labor market segmentation by narrowing differences in severance pay entitlements across contract types, lowering severance for open-ended contracts while introducing or strengthening severance rights for temporary workers (OECD 2017).

Regulatory neutrality principles should be explicitly extended to platform work. Regulation should be guided by the characteristics of the job—its tasks, responsibilities, rights, and degree of autonomy—rather than by the mere fact that the work is performed through a digital platform. Where platform workers operate under conditions comparable to salaried employment, particularly in terms of managerial control, they should be regulated as employees. Conversely, where platform workers retain a high degree of autonomy and resemble independent contractors, regulation should reflect that status.

This contrasts with approaches such as Spain's, which introduced a legal presumption of employment for delivery platform workers. While this set an important precedent, recent evidence suggests negative effects, including reductions in employment and earnings (Box 8.1). A different but also problematic approach is Mexico's 2024 reform (Chapter 4), which classifies workers based on earnings thresholds—an imperfect proxy, since income does not necessarily reflect the nature of the employment relationship. A more balanced approach is found in Chile and Uruguay, where regulations combine minimum universal protections for all platform workers with flexible classification frameworks. In practice, this ensures a baseline of protections for all platform workers—such as occupational safety and the right to unionize—while allowing other rights and obligations to vary according to the degree of autonomy and subordination in the work relationship.

However, while promising, this approach can place part of the burden of proof on workers and operate in gray areas where employment is neither clearly dependent nor fully independent. Its effectiveness therefore depends on accessible dispute resolution mechanisms and strong, targeted enforcement. It also requires algorithmic transparency, whereby platforms disclose to regulators and workers the logic, criteria, and data behind automated decisions that materially affect income or access to work. This is essential for effective enforcement, enabling authorities to detect and correct unfair or discriminatory practices while also protecting workers from opaque or arbitrary decisions. Finally, it requires addressing the labor market power of platforms. In this regard, data portability—as in Chile and Uruguay—which allows workers to access and control their reputation data, is key to reducing vulnerability to platform dependency by enabling mobility across platforms. Safeguarding the rights to organization and collective bargaining is also critical.

BOX 8.1 REGULATING PLATFORM WORK: THE GLOVO CASE IN SPAIN AND THE EUROPEAN APPROACH

In 2020, Spain's Supreme Court ruled that couriers working for the delivery app Glovo were employees, not independent contractors. The ruling emphasized that the platform's algorithm-controlled pricing, order assignment, and performance monitoring amounted to effective subordination. This precedent influenced Spain's broader Rider Law (2021), which provided a *legal presumption of a dependent employment* relationship for all digital platform workers in the delivery sector. It also introduced a right to "algorithmic transparency" at a national regulatory level for the first time, setting an important precedent.

The law increased formal employment in the short term (ESADE 2022), but there is evidence that the rigidity of this legal presumption led to a reduction in the number of delivery platform workers, hours worked, and average wages (Cabo and Fernández-Kranz 2023; Dolado, Jáñez, and Wellschmied 2025) and an increase in subcontracting. The law had implications across Europe. In March 2024, the European Union (EU) enacted the EU Platform Work Directive, which sets new rules that the 27 EU member states must implement by 2026. It introduces a rebuttable *legal presumption of employment* when facts indicating control and direction are found. If the platform wants to rebut this presumption, it must prove that the contractual relationship in question is not an employment relationship. It also requires platforms to inform workers about automated monitoring and decision-making systems and limits their use of workers' personal data.

It is crucial to address contractual arbitrage via outsourcing not only by closing legal loopholes but also by reducing the incentives to engage in it. As discussed in Chapter 4, a common strategy to circumvent labor obligations is subcontracting, whereby workers are formally employed by one firm but in practice work for another. Empirical evidence shows that such practices are often associated with negative impacts on workers' compensation and welfare. In cases in which outsourcing is used primarily to circumvent labor regulations or weaken workers' bargaining power, rather than to improve productivity, the associated loopholes should be closed.

Mexico offers an interesting example of how to tackle this challenge. As detailed in Box 8.2, authorities raised well-founded concerns that outsourcing was widely used to circumvent labor regulations through contractual arbitrage. In response, Mexican authorities implemented a reform strategy along two complementary fronts. First, they closed legal loopholes by clearly restricting the use of outsourcing to evade labor obligations. Second, and critically, by adjusting a regulation on profit sharing, they reduced firms' incentives to rely on outsourcing in the first place. In this way, the reform not only strengthened the law but also addressed the underlying incentives to violate it.

It is crucial to address contractual arbitrage not only by closing legal loopholes but also by reducing the incentives to engage in it.

**BOX 8.2 OUTSOURCING, PROFIT SHARING, AND MONOPSONY POWER:
EVIDENCE FROM MEXICO⁵²**

The restriction of domestic outsourcing practices in Mexico provides an interesting policy example of how to increase the labor share without affecting employment or output levels. In Mexico, domestic outsourcing increased from 6 percent of the labor force in 2004 to over 15 percent in 2019. Authorities suspected that outsourcing may have been used to avoid profit-sharing requirements, since Mexican law requires companies earning over US\$15,000 annually to distribute 10 percent of pre-tax profits to eligible employees, including temporary workers who worked more than 60 days.

The 2021 Mexico outsourcing reform allowed only the subcontracting of specialized services not related to the core business activities of the beneficiary; created a registry at the Ministry of Labor, where service providers must register and show compliance with labor and social security obligations; and introduced sanctions and up to three years in prison for non-law-abiding firms. The reform also introduced a cap on profit sharing, setting the limit at either three months of the employee's salary or the average profit-sharing amount received over the past three years. Additionally, a new calculation method for profit sharing was established: 10 percent of a company's net profits is now split into two parts—one distributed based on the number of days each employee worked, and the other based on their earned salary.

The reform was controversial, with critics arguing it would reduce overall employment; however, recent evidence suggests otherwise. Colonna and Aldeco (2025) found that most firms responded by insourcing workers directly, reducing the share of establishments outsourcing more than 95 percent of their workforce, and triggering profit-sharing payments among previously exempt firms. Total labor compensation—wages plus profit sharing—rose approximately 3 percent in the first post-reform year, with no detectable effect on total employment or hours worked. It also reduced labor market markdowns—the gap between workers' marginal product and their wage—by 27 percent across a 20-year panel of Mexican firms (Estefan et al. 2024). They find a modest increase in market exit probability and a small reduction in capital investment but no decline in dividends paid, suggesting that adjustment costs fell primarily on firm rents rather than productive capacity.

52. This box mainly summarizes the findings by Colonna and Aldeco (2025) and Estefan et al. (2024).

Flexibility in contractual regulations should be expanded alongside care policies to boost female labor force participation.

Flexible work arrangements (FWAs) are contractual forms that modify when, where, or how work is performed relative to standard fixed schedules. They help workers better reconcile professional and personal responsibilities by adapting working time and conditions to individual needs. FWAs include options such as telework in suitable occupations, flexible scheduling, and greater predictability of working hours, among others. Evidence highlights their relevance for labor market outcomes. For instance, in Colombia, women are willing to accept lower wages in exchange for flexible schedules within full-time contracts (Bustelo et al. 2023). More broadly, FWAs can raise female labor force participation by lowering barriers linked to time constraints and care responsibilities.

Several lessons emerge from their application. First, FWAs are most effective when they are broadly accessible across the workforce, particularly for workers who lack the financial means to absorb work–life conflicts. This requires expanding their scope beyond telework to include flexible hours, schedule predictability, and adequate technological and organizational support. Evidence from Australia, for example, shows that schedule predictability can be as important as flexibility itself (Box 8.3).

Second, sustained gains in women's participation depend on combining FWAs with complementary labor and social policies that reduce care-related constraints, such as parental leave and accessible childcare and long-term care services. While FWAs can facilitate labor market entry and continuity, they may also reinforce traditional gender roles if care responsibilities remain unevenly distributed, potentially widening gender pay gaps. Addressing gender inequalities in the labor market therefore requires not only greater flexibility at work but also the expansion of affordable and accessible care services. Box 8.3 highlights the case of the Australian Fair Work Act, which allowed parents to request changes in working arrangements along multiple dimensions, with positive labor market outcomes for women. The policy obligation to have transparent processes to request gender-neutral flexibility arrangements could help democratize this benefit (Araujo et al. 2024; Stampini et al. 2025).

BOX 8.3 LESSONS FROM THE AUSTRALIAN FAIR WORK ACT (2009)

The Australian Fair Work Act entitled parents of young children to request changes in working arrangements, including whether schedules are predictable or on call, whether work must be performed at a specific location, whether hours are rigid or flexible, and whether one full-time job could be shared by two part-time workers. Its deliberately vague and gender-neutral wording allowed employees (be they mothers or fathers) to tailor requests to their needs. The reform had significant effects on participation and showed a strong preference for predictable hours: when new mothers were able to request changes in working arrangements, they chose predictable schedules rather than other forms of flexibility, and the “child penalty” in working hours declined by around 30 percent. The reform also supported the retention of female workers in the labor force, as post-birth participation declined less among women affected by the law than among those who were not, and the reduction in weekly hours worked was about three hours smaller, resulting in higher earnings. Importantly, the policy had no significant effect on men’s hours worked or on the female share of work at home (Ciasullo and Uccioli 2022).

A more equal sharing of childcare should be promoted through nontransferable, paid leave entitlements for fathers financed through social security. Leave policies can take three forms: maternity leave for mothers around childbirth, paternity leave for fathers, and parental leave as a shared, gender-neutral entitlement. In the region, parental leave remains limited, and the gap between maternal and paternal entitlements is still large (Chapter 4).

Evidence shows that transferable parental leave tends to be disproportionately taken up by mothers, with negative effects on women’s careers (Faundez 2019; Olivetti and Petrongolo 2017). By contrast, nontransferable father-specific leave—so-called “fathers’ quotas”—increases men’s uptake and involvement in childcare, particularly when benefits are generous (Canaan et al. 2022; Albrecht et al. 2024; Castro-García and Pazos-Morán 2016). Generous and nontransferable leave also has an important spillover: shifting gender-role beliefs of caretaking (Kleven et al. 2026).

Evidence also highlights the importance of how leave is financed. Cost-sharing mechanisms are key to promoting gender equity in leave policies without unintended negative effects. A cost-benefit analysis of Brazil’s Programa Empresa Cidadã shows that longer parental leave can benefit firms by reducing turnover costs (Britto et al. 2025). However, small firms often face financial constraints that limit their ability to offer leave and may reduce female employment (Box 8.4). In this context, expanding parental leave without the support of shared financing through social security can be difficult in a region with already high labor costs, especially for small firms.

BOX 8.4
**PROGRAMA EMPRESA CIDADÃ: BRAZIL'S EXTENDED
MATERNITY AND PARENTAL LEAVE PROGRAM**

In 2008, Brazil created the Corporate Citizen Program (Programa Empresa Cidadã) to extend maternity leave by 60 additional days for workers in participating firms. Participating firms could deduct the full salary paid during the extended leave from their corporate income tax. Two subsequent modifications allowed the extension of paternity leave from 5 to 20 days, and parental sharing of the maternity leave extension, but only if both parents work for firms enrolled in the program. It also introduced flexible use of the extension, allowing 120 days at a 50 percent replacement rate.

Where adopted, results were positive overall: eligible firms saw a 6.3 percentage point increase in female employment and retention, and a 57 percent earnings gain over the first 24 months postpartum. The strongest effects were among younger, lower-educated women (Britto et al. 2025). However, Souza (2024) found that earnings and leadership gains accrued mainly to childless women, while outcomes for mothers themselves declined. At the same time, firm take-up has remained limited. Around 13 percent of eligible firms signed up for this program 12 years after its introduction (Souza 2024) and 35.7 percent of eligible mothers ultimately took it up (Machado, Neto, and Szerman 2023). For family-friendly policies to be effective at promoting gender equity within firms, it is not enough that support is available; it must be universally accessible and actively utilized.

B) Dismissal Procedures and Unemployment Protection: Balancing the Trade-Off between Protecting Workers and Protecting Jobs

As discussed in Chapter 4, a core function of labor law is the regulation of dismissals, and severance pay is a central instrument in that system. It is one of the most widespread labor market institutions in the region and is often enshrined in national constitutions. It serves important objectives: discouraging excessive turnover in high-turnover sectors, internalizing the social costs of dismissals, and constraining arbitrary or discriminatory employer behavior. However, problems arise when severance pay is also expected to function as an instrument of social protection. Despite its prevalence, severance pay is a weak mechanism for income protection: benefits are tied to tenure rather than the duration of unemployment, coverage is uneven, and large severance liabilities can exacerbate firm insolvency during economic shocks.

Incremental adjustments should be made to severance pay to strengthen worker protection while reducing the risk of accelerating firm bankruptcy during crises.

Despite these limitations, severance systems have seen little structural reform, reflecting strong political and institutional barriers. More broadly, progress in strengthening unemployment protection has been limited. Unemployment insurance, the most effective tool for income security and risk pooling, remains rare. Where introduced, individual savings accounts have complemented severance schemes, but they often provide insufficient protection, especially for low-income and short-tenure workers, and savings are frequently diverted to other uses such as housing or education.

As a result, workers in the region remain poorly protected against the risks associated with job loss. This gap is particularly concerning in the context of structural shocks, such as technological change or energy transition policies, that may generate large-scale worker displacement. Against this backdrop, three gradual reform paths can be considered.

Incremental adjustments should be made to severance pay to strengthen worker protection while reducing the risk of accelerating firm bankruptcy during crises. Table 8.2 provides a useful reference to compare unemployment protection instruments. While severance pay and unemployment insurance traditionally occupy opposite ends of the policy design spectrum, the following gradual and targeted modifications can help align severance with the protective, portable, and countercyclical features of unemployment insurance:

- (i) **Shift to collective pre-funding:** Instead of relying only on severance paid directly by the employer at dismissal, part of the contributions could be pooled into a shared fund. This would help spread costs across firms and, over time, ensure severance can be funded, even when firms become insolvent. It would also reduce litigation costs and lower the risk that severance obligations contribute to firm bankruptcy.

Portugal offers a useful example. In 2013, it established two dismissal-related funds—the *Fundo de Compensação do Trabalho* (FCT) and the *Fundo de Garantia de Compensação do Trabalho* (FGCT)—both financed through mandatory employer contributions. Employers can use savings accumulated in the FCT to cover severance obligations when terminating contracts. If an employer fails to pay or pays less than the statutory minimum, the FGCT guarantees that the worker receives at least 50 percent of the legally mandated

compensation. This system lowers the employer's immediate payment and liquidity burden while ensuring a minimum level of protection for workers. If the worker resigns voluntarily, the employer can recover the full amount saved in the FCT.

Another promising approach is the establishment of sectoral funds, particularly in industries with high turnover. These funds could be administered by employers' associations under appropriate regulatory oversight, with the option of public co-financing to ease the procyclical financial burden during economic downturns. To enhance labor mobility, such funds could be designed to allow portability of entitlements for workers who change employers within the same sector. Austria's severance fund for the construction sector, BUA, provides a good example: it is collectively funded and ensures that severance entitlements are portable across employers. Given the intermittent nature of employment in construction, periods of employment are aggregated—provided specific conditions are met, including that the worker was not dismissed for misconduct.

- (ii) **Transition from lump-sum to periodic payments:** Converting severance into a stream of periodic payments would enhance its consumption-smoothing function, aligning it more closely with the design of unemployment insurance, while also being more affordable for firms, particularly small and medium-sized enterprises (SMEs). For example, a 2010 labor reform in Greece introduced provisions allowing severance payments exceeding two months' wages to be paid in installments. Over time, these payments could be linked to participation in active labor market programs to support reemployment. Moreover, this may reduce pressure on firms that are terminating workers in the context of a negative shock, lowering the risk that lump-sum severance obligations accelerate bankruptcy.
- (iii) **Revise benefit formulas:** Standardizing severance pay calculations with uniform rates per year of service and clear caps improves predictability and transparency and reduces disputes.

TABLE 8.2 COMPARISON OF UNEMPLOYMENT PROTECTION INSTRUMENTS

DESIGN FEATURES	SEVERANCE PAY	UNEMPLOYMENT INDIVIDUAL ACCOUNTS	UNEMPLOYMENT INSURANCE (UI)
Definition	Lump sum paid by the employer at dismissal, usually for dismissals without just cause	Pre-funded savings in an individual account for use during unemployment	Social insurance providing temporary income replacement during unemployment, funded collectively
Funding source	Employer, at time of separation	Employer (and sometimes employee), during employment	Employers, employees, and/or government, typically through payroll taxes
Timing of cost	Upon dismissal; back-loaded	During employment; front-loaded	Spread over time via regular contributions
Portability	No; tied to tenure with a specific employer	Yes; portable across jobs	Yes; eligibility based on contribution history, not employer
Eligibility conditions	Usually limited to unjustified dismissals	Often accessible for any unemployment, depending on design	Involuntary job loss with minimum contribution period
Incentives	May discourage formal hiring or encourage litigation over dismissal cause	Lower dismissal litigation risk; separation costs are pre-funded	Can reduce incentives to search for work quickly unless activation measures are included
Adequacy of protection	Depends on tenure and wage; no protection for short-tenure workers	Depends on accumulated balance; limited early in career	Provides broader risk pooling; can offer stable income regardless of tenure
Redistribution	None; fully individual and tenure-based	Limited; tied to own savings	Yes; redistributes from high earners/long tenure to low earners/short tenure
Macroeconomic stabilization	Weak; no automatic response to economic downturns	Limited; stabilizes only for individuals who saved enough	Strong; countercyclical spending supports demand in recessions
Administrative complexity	Moderate, but often triggers litigation	Requires individual account management	High; requires claims processing, verification, and compliance mechanisms, but costs may fall with technological improvements
Who bears the risk?	Employer	Individual	Society (via pooling)
Best for...	Long-tenured workers	Stable savers, portable careers	Broad-based protection in economic downturns

Source: Authors' elaboration.

In countries with individual unemployment accounts, protection should be strengthened by adding features typically associated with unemployment insurance. Key changes include pooling resources across workers or sectors to better spread the cost of unemployment and linking benefits to active labor market policies: for example, adding a bonus to savings-based payments to encourage job search. In this regard, Chile and Ecuador offer interesting examples of unemployment benefit systems that combine individual savings with elements of collective support.

As detailed in Box 8.5, Chile's unemployment insurance combines individual accounts funded by mandatory employer-employee contributions with benefits from a solidarity fund financed through employer contributions and general taxation. Recipients first draw on their individual accounts and only access the solidarity fund once their personal savings are depleted. Access to the solidarity fund requires that the worker meet standard unemployment insurance eligibility criteria—such as being unemployed, available, and actively seeking work—and withdrawals are limited to two within a five-year period. Benefit levels depend on past earnings, with replacement rates declining to encourage reemployment: they start at a 70 percent replacement rate in the first month and decline to 30 percent by the sixth month (OECD 2022). The decline in replacement rates and the use of individual savings before accessing the solidarity fund aim to reduce moral hazard, while the solidarity component ensures a minimum level of protection for workers with limited savings capacity. These are very positive features; however, as discussed in Box 8.5, the system still requires further efforts to expand coverage.

Ecuador provides another example. In 2016 the system evolved from a purely individual savings account scheme to a mixed model combining solidarity insurance with individual accounts. Unlike Chile's system, Ecuador's guarantees a minimum floor of 70 percent of the minimum wage for individuals with low balances. At the same time, it partially reduces moral hazard by encouraging workers to use their own savings to co-finance unemployment benefits—an interesting feature that strengthens solidarity. However, like Chile's, Ecuador's system still faces coverage challenges. Low coverage reflects high informality, but the system also has strong eligibility requirements that are stringent by international standards.

Moreover, for workers without sufficient savings balances, benefits remain relatively low. Actuarial studies suggest, however, that the system has ample financial space to expand coverage: in 2022, its financial reserves amounted to as much as 85 times the insurance's projected annual expenses through 2028 (ILO 2022).

BOX 8.5 UNEMPLOYMENT INSURANCE IN CHILE AND ECUADOR

Chile and Ecuador both combine individual unemployment accounts with a solidarity fund, but differ substantially in financing, eligibility design, and benefit structure.

	CHILE (SINCE 2002)	ECUADOR (SINCE 2016)
Administrator	AFC Chile (private), supervised by Superintendency of Pensions.	IESS (public).
Financing	<i>Tripartite:</i> Employer 2.4% (1.6% individual + 0.8% solidarity) Employee 0.6% (individual only); Government: fixed annual transfer to solidarity fund.	<i>Bipartite:</i> Employer 0.5% (solidarity fund) Employee 2% (individual severance account).
Eligibility for individual account funds	<i>Any reason for unemployment.</i> Requires 10 contributions to be eligible (noncontinuous, from different employers) for open-ended contracts; 5 contributions for fixed-term contracts.	<i>Only involuntary dismissal.</i> Requires 24 noncumulative contributions to be eligible, including 6 consecutive prior to dismissal.
Eligibility for solidarity funds	Dismissal without just cause; 10 contributions; minimum benefit guaranteed for low-income workers with insufficient individual balance.	Same as above; worker selects benefit option at application.
Benefit structure	Individual account drawn first; solidarity fund supplements if account insufficient for 5 payments.	Option A: solidarity only (account untouched); Option B: solidarity + individual account combined.
Replacement rate	70% → 30% over 5 months (minimum floor).	70% → 50% over 5 months.
Benefit duration	Up to 5 months.	Up to 5 months; full individual balance withdrawable if still unemployed after 5 months.
Retirement link	Unspent individual account balance transferred at retirement.	Individual account balance transferred to pension account if UI was never claimed.
Coverage (latest available)	27% of affiliated workers received some benefit while unemployed (OECD 2025).	In actuarial models, it is estimated that 2% of affiliated unemployed workers would qualify to receive a benefit (ILO 2022).

Strict or ambiguous dismissal regulations—rules that, while intended to protect workers, inadvertently discourage formal hiring and encourage legal circumvention—should be gradually eliminated. A case in point is reinstatement provisions such as those in Costa Rica, Honduras, Peru, Panama, and Mexico. While some view reinstatement as a safeguard against arbitrary dismissal, its drawbacks are substantial: it creates legal uncertainty, prolongs litigation, and often prompts employers to settle to avoid the risk of having to reinstate a former employee. Moreover, when reinstatement is enforced, it frequently fosters tension and distrust between workers and employers, undermining collaboration, especially after contentious dismissal disputes. In practice, it can also incentivize the use of alternative, less secure forms of employment to circumvent reinstatement, thereby eroding job stability.

As discussed in the analysis of Peru by Jaramillo, Almonacid, and De la Flor (2019), although reinstatement is relatively rare in practice, the potential legal obligation increases the expected cost and risk of dismissals, encouraging firms to rely more on fixed-term hiring. In fact, as seen in Chapter 2, in Peru only 14 percent of salaried workers hold permanent contracts—the lowest share in the sample. Thus, reinstatement represents an excessive and often counterproductive feature of employment protection legislation, especially if it is applied widely and without the possibility of avoidance by paying an additional cost (as in the case of Panama). Ideally, it should be avoided, outside of exceptional and well-defined cases such as proven discriminatory dismissals, rather than treated as a constitutional or automatic right for all workers.

Also, when designing dismissal regulations, a crucial feature to consider is not only their strictness but also their clarity. Ambiguity in legal provisions can have equally harmful effects. A telling example is Colombia's law protecting workers with disabilities, which requires special authorization for dismissal even in cases of just cause. As discussed in Chapter 4, unclear wording and contradictory judicial interpretations have strongly discouraged employers from hiring workers with disabilities, due to the legal complications involved in terminating contracts.

To improve the effectiveness of dismissal regulations, reforms should focus not only on their strictness but also on the ambiguity and legal uncertainty they create.

In fact, promoting job stability is sometimes better achieved not by increasing the severity of regulations but by reducing both the level and the uncertainty of firing costs. This was the case in Italy in 2014, when a hiring subsidy that lowered labor costs, combined with new regulations that reduced and clarified firing costs, led to a marked increase in the share of permanent contracts relative to fixed-term ones (Sestito and Viviano 2016). These lessons suggest that protecting workers requires balancing reasonable safeguards with clear, predictable rules, rather than relying on overly rigid or ambiguous provisions that ultimately undermine the very stability they aim to promote.

Countries should consider alternative approaches to addressing the externalities of dismissal, such as a dismissal tax, rather than relying primarily on traditional severance pay. As discussed in Chapter 4, severance pay is sometimes justified to discourage excessive layoffs, which generate negative social externalities, particularly in industries with high turnover. An alternative approach is a dismissal tax, under which the employer, instead of paying severance directly to the worker, contributes to a fund that finances unemployment insurance. This design can both discourage excessive terminations and strengthen income protection during unemployment, since unemployment insurance tends to provide more effective support than severance alone. For example, in Italy, employers are required, upon the dismissal of a permanent employee, to pay a contribution to the social security system—the ticket di licenziamento—which helps finance unemployment benefits.

Countries should consider alternative approaches to addressing the externalities of dismissal, such as a dismissal tax, rather than relying primarily on traditional severance pay.

C) Protecting Income for All, Even During Aggregate Shocks

As discussed throughout this book, income protection in Latin America and the Caribbean was introduced in the mid-twentieth century, inspired by the Bismarckian model, with the goal of using employer–employee contributions to protect workers against sickness, old age, and income shocks. It assumed most workers would hold stable, formal wage jobs with clear employment relationships, so social protection would rely on contributory insurance and labor regulations tied to wage work. Payroll contributions became the main financing mechanism due to administrative convenience, as employers could report wages and collect contributions more easily than the state could mobilize broad-based taxation. At the same time, labor rules aimed to ensure

job stability during industrial expansion. However, labor markets in the region never fully matched this model: today, salaried employment is only 63 percent of jobs, leaving many self-employed, part-time, and informal workers outside the contributory system.

This highlights the need to move toward a more comprehensive and sustainable social protection architecture. And moving in that direction implies revising the role of employer-employee payroll contributions in financing social protection. Payroll contributions have important advantages: they provide a stable and predictable source of revenue, are generally more insulated from short-term political cycles than general taxation, and are usually easier to collect. Moreover, by linking contributions to labor earnings, they can also foster a sense of solidarity within the workforce.

However, their use to finance social protection also has important drawbacks discussed throughout the book. It increases the cost of formal wage employment relative to capital and nonwage work, which can discourage formal hiring and reduce efficiency. It also generates exclusion: independent workers can be left out of contributory systems or included under weaker enforcement or lower contributions. In addition, as noted in Chapter 4, many countries are approaching practical limits to payroll financing, with contribution rates already above 20 percent (e.g., Bolivia, Colombia, and the Dominican Republic), and, in some cases, close to or surpassing 30 percent (e.g., Brazil, Uruguay, and Argentina). As such, further increases in contribution rates will likely face significant challenges. This underscores the need to explore alternative funding sources, as outlined below.

A crucial goal is to ensure alignment between the risks covered under social protection systems and their financing source, while guaranteeing that all individuals face the same type of coverage for a given risk. Following Levy and Cruces (2021), a central principle for designing social protection is, first, to ensure equity in coverage by guaranteeing that all individuals exposed to a given risk are covered through the same program with a consistent financing source, and, second, to align the source of funding with the nature of the risk being covered.

This second point rests on a simple observation: the risks covered by social protection systems differ depending on who is exposed and whether they are linked to work. Some risks affect only salaried workers within firms, others affect all workers, and others affect the population at large. Table 8.3 uses this framework to classify different risks and match them with appropriate sources of funding. The bottom two rows refer to the first type of risks, those affecting salaried workers. Because these risks are directly related to the nature of their jobs, financing them through payroll contributions is appropriate. Payroll contributions help employers internalize the social costs associated with these risks, ensuring that those facing

higher risk profiles contribute more, while avoiding the inequitable outcome in which general taxpayers subsidize high-risk employers. Occupational hazards are a clear example: injuries or illnesses directly linked to job characteristics should be covered through payroll-based contributions, with rates varying according to risk levels. Firms with higher accident rates should pay higher premiums, creating incentives to improve workplace safety and, in turn, support productivity gains.

TABLE 8.3 PROPOSED COVERAGE AND FUNDING SCHEMES FOR KEY SOCIAL PROTECTION RISKS

RISK	COVERAGE	PROPOSED FUNDING SCHEME
Illness	All individuals, same services	General revenues
Longevity — old-age poverty	All the elderly, flat pension	General revenues
Longevity — consumption smoothing	All workers (including self-employed). Pension proportional to savings	Earmarked personal income taxes
Income loss due to death or disability	All workers (including self-employed). Pension proportional to savings	Earmarked personal income taxes
Income loss due to firm-worker separation	All salaried workers	Payroll contributions or dismissal compensation depending on cause
Occupational hazards and accidents at the workplace	All salaried workers	Payroll contributions

Source: Authors' elaboration based on Levy and Cruces (2021).

A crucial goal is to ensure alignment between the risks covered under social protection systems and their financing source, while guaranteeing that all individuals face the same type of coverage for a given risk.

By contrast, universal risks—those that exist independently of employment and affect all individuals—should not be financed through payroll contributions. Illness is the clearest example: genetic conditions or chronic diseases are unrelated to a person's job, and thus financing health care through payroll taxes lacks justification. Moreover, this approach generates inequities, as salaried workers will have easier access to the contributory health systems than the rest of the population. Instead, health protection should be funded exclusively (or at least, primarily) through general taxation, which guarantees universal access. In this regard, a notable example is Brazil's transition

from a fragmented, employment-based health insurance model to the Unified Health System (*Sistema Único de Saúde*), a universal, general tax-funded model initiated by the 1988 Constitution and gradually implemented through decentralized service expansion, which became one of the world's largest and most equitable public health systems and dramatically expanded access for more than 200 million people (Fletz et al. 2025).

Another notable example is Colombia's 2012 tax reform, which reduced employer payroll contributions by 13.5 percentage points for workers earning less than 10 minimum wages, who constitute most employees. The reform eliminated employers' contributions of 8.5 percent for mandatory health insurance, 3 percent for childcare, and 2 percent for the national training agency. To offset the resulting loss in payroll tax revenue, it increased corporate income taxation by reducing exemptions that firms had previously used to lower their taxable income, thereby shifting the tax burden toward more general forms of taxation. Evidence indicates that the reform had positive effects on formal employment and wages. While estimated magnitudes vary across studies and methodologies, the effects are generally sizable and concentrated among smaller firms and workers with lower levels of education (Bernal et al. 2017; Kugler, Kugler, and Herrera Prada 2017; Fernández Mejía and Villar 2017).

With respect to unemployment insurance, since the risk of income loss due to firm-worker separation is also associated with the nature of the job, financing of unemployment insurance should also be tied to employer-employee contributions. Importantly, unemployment benefits should be conditional on participation in active labor market policies, such as training and active job search, to strengthen reintegration and employability.

Moreover, when reforming unemployment insurance, it is important to acknowledge what these systems can and cannot achieve. Unemployment insurance is effective at protecting workers from temporary, individual job losses, but it struggles to provide adequate support during large-scale crises, as the pandemic demonstrated. For example, even in Chile—where formality rates are higher than in most other countries in the region, the unemployment insurance system is relatively mature, and social relief spending during the crisis was the highest in Latin America and the Caribbean—many displaced workers received little or no income support in the early months (OECD 2022). In these situations, noncontributory social protection programs become essential.

With respect to pension systems, it is useful to distinguish between two objectives. The first is preventing old-age poverty, which applies to all older adults regardless of their labor market history and therefore should be financed from general revenues rather than linked to the nature of work. The second, consumption smoothing, is a goal derived from the tendency of individuals to prioritize present needs over future consumption, which can leave them

unprepared for retirement. This second goal should be mainly addressed by a contributory system, whether defined benefit or defined contribution, that requires workers to save part of their labor income for retirement to smooth consumption and manage longevity risks. However, such a system should be designed differently from what is typical in Latin America and the Caribbean: it should be accessible to all workers, regardless of their type of work, and contributions should be based solely on income levels, not on whether the worker is salaried or self-employed. For countries such as the Dominican Republic, Mexico, and Peru, this would imply making contributions mandatory for all workers, not only salaried employees, with payments potentially collected through earmarked personal income taxes (Table 8.3).

Thus, the goals of preventing old-age poverty and smoothing consumption could be achieved through noncontributory and contributory pillars that, ideally, are integrated. Such integration would not only lower administrative costs and improve targeting, but could also reduce average contribution rates, as discussed in Box 8.6.

BOX 8.6
DESIGN PENSION SYSTEMS THAT BOTH ADAPT TO AND FIGHT AGAINST LABOR INFORMALITY

The first pillar we recommend is a universal, noncontributory pension, paid to all older adults regardless of employment history or contribution status. The level should be sufficient to combat old-age poverty by providing a minimum floor for all seniors. Crucially, this pension should be universal: individuals who receive contributory pensions should continue to receive the universal benefit.⁵³ This design ensures basic coverage that is independent of the individual's work and contribution history and removes the incentive to avoid formality to qualify for social assistance. The second pillar we recommend is a contributory pension that complements—instead of replacing—the universal pension. Contributions should be tied to the individual, not to a specific job, and calculated based on total annual income, ideally integrated into the personal income tax system. Income from salaried work and income from independent work should be treated equally, meaning that the sum of employer and employee contributions in the case of salaried work should equal the contribution rate for independent work. We recommend no minimum contribution requirement to receive a pension: each year of contributions generates a proportional pension benefit, which is then added to the baseline universal pension. This eliminates sharp eligibility thresholds that

53. Some countries might adjust the design so that the highest-income earners are excluded from receiving this universal pension, but the fact that most formal workers will receive the universal pension in addition to the contributory pension is crucial for the design we propose.

penalize intermittent or informal careers. Figure 8.1 presents the composition of the total pension for workers of different income levels, including the voluntary savings component we will address shortly.

Expected benefits and contribution rate by income level under the proposed design

FIGURE 8.1 EXPECTED BENEFITS AT OLD AGE ACCORDING TO INCOME LEVEL

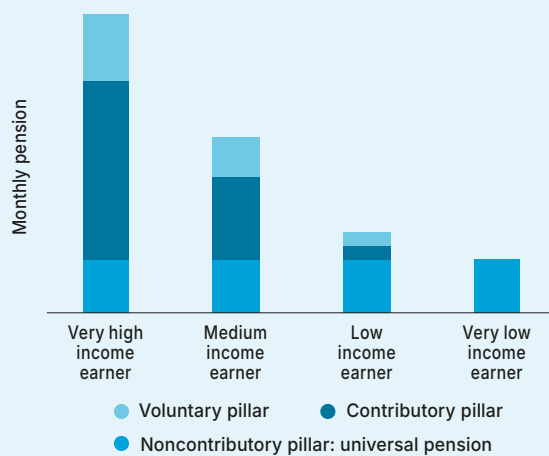
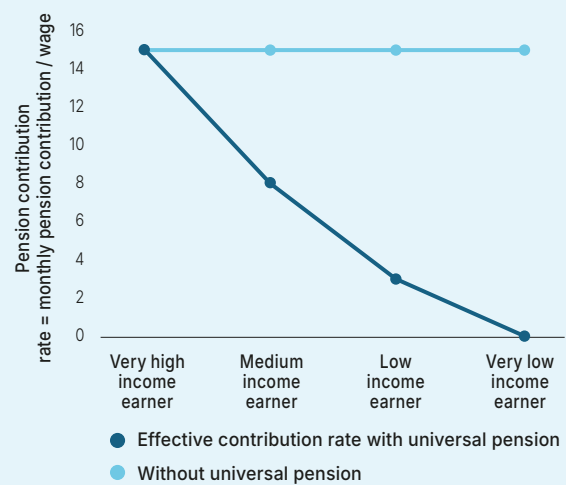


FIGURE 8.2 EFFECTIVE CONTRIBUTION RATE ACCORDING TO INCOME LEVEL

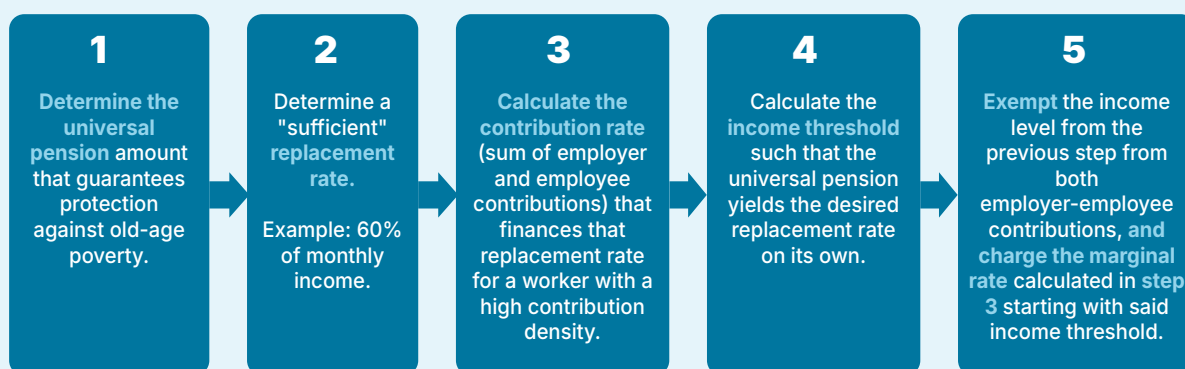


Source: Authors' elaboration.

We recommend two additional features for the contributory pillar. First, we recommend it be actuarially fair: contribution rates should be calibrated to finance the desired replacement rate to bridge the gap between the universal pension and a sufficient pension, at least for a worker who contributes consistently throughout working age. Second, we recommend that contributions apply only above an income exemption threshold, like personal income taxes in most countries. Importantly, this threshold ought not to be linked to the minimum wage and could be set above or below the minimum wage without causing a problem for the design, in line with the principle of regulatory neutrality. The threshold would be defined as the income level at which the universal pension alone delivers the target replacement rate. For low-income workers, this would imply a significant reduction (or elimination) of the pension contribution, both for the worker and for the employer, making pension rates progressive compared to a flat rate, as seen in Figure 8.2. This design improves the incentives for formality the most for low-wage workers, who have the highest rates of informality.

Finally, we recommend a voluntary savings pillar to complement mandatory components by leveraging behavioral tools such as default enrollment with an opt-out mechanism, or simplified savings products. However, the voluntary pillar would not rely on public subsidies that could reintroduce distortions or fiscal regressivity. It would simply function as an optional savings mechanism for workers who want to contribute a higher amount to their pension. Figure 8.3 presents a schematic way to implement the design we recommend. It is based fundamentally on two policy decisions: (i) the amount of the universal pension that would eliminate old-age poverty; and (ii) the replacement rate that is considered sufficient for a worker who contributes during most of her working life (a high-contribution-density worker). These two decisions, combined with some actuarial calculations, would be sufficient to finish the design.

FIGURE 8.3 STEPS TOWARD A MORE INCLUSIVE AND EFFICIENT PENSION SYSTEM



Source: Authors' elaboration based on Ripani et al. (2023).

Together, this architecture protects all older adults from poverty, ensures that pension contributions always result in higher pensions, aligns pension contributions with individuals' lifetime earnings capacity, and improves the incentives for formal employment, making the pension system part of the solution to informality rather than one of its causes. Furthermore, the actuarially fair contributory pension avoids the pitfall of subsidizing contributory pensions, which are disproportionately received by high-wage workers, thereby avoiding the regressivity that plagues many systems. The actuarially fair nature of the contributory pension is also key for the financial sustainability of the design, despite the expansion of the noncontributory pillar. We conclude with an additional attractive feature of this design: under this scheme, an increase in the amount of the universal pension improves labor market incentives by exempting more income from pension contributions and lowering the nonwage cost of formal employment. Such an increase in the amount of the universal pension, in addition to being an important policy from the perspective of social protection, could now also be viewed as an investment in labor formality and productivity.

Make the necessary technological investments to establish a unified platform for income tax and social security contributions. This is key to facilitating coverage among independent workers, those with multiple jobs, part-time workers, and those with seasonal income. Much in the same way that personal income taxes are calculated, essentially by summing income from all sources each year to determine the tax liability, the sum of income from all sources should determine pension contributions (Table 8.3). This feature will make it easier to handle labor market transitions between different types of jobs, multiple job holdings, and incomes that fluctuate considerably during a year.⁵⁴ It relies critically on digital systems capable of integrating income information across employers, workers, and income sources.

Chile's experience integrating tax and social security payments for independent workers, detailed in Box 8.7, offers several important lessons in this regard. First, a gradual approach was critical. This sequencing allowed the contributor base to expand progressively before participation became mandatory. Second, the reform leveraged existing payment channels to fully integrate social security contributions into the annual income tax collection process for independent workers. This was facilitated by unique taxpayer and contributor identification numbers and an integrated online platform, which enabled Chile's internal revenue service (Servicio de Impuestos Internos, SII) to assume responsibility for calculating social security contributions. Countries seeking to replicate this model should therefore plan for sequential, gradual reforms and ensure that their tax administration and digital infrastructure can support an expanded role in social security administration. Related to this second point, and as discussed by Azuara et al. (2023), there is a practical path—similar to Chile's—that countries in the region can follow to facilitate the enrollment of self-employed workers by leveraging existing technologies and innovative approaches to streamline processes that go from enrollment and registration to payments and collection.

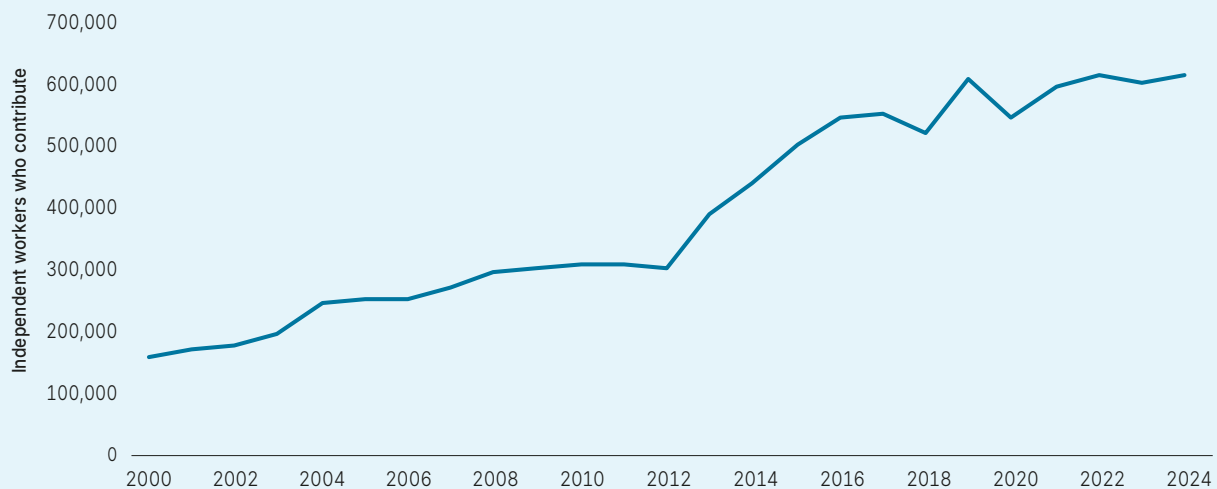
54. It would also ensure proportionality: the employer contribution for hiring two half-time workers would equal that of hiring one full-time worker, with the combined benefits of the two part-time workers matching those of a full-time worker, thereby reducing distortions while improving equity. Aligning the treatment of part-time and full-time work in this way would also support gender equality, as women are significantly more likely than men to work part-time.

**BOX 8.7 INTEGRATION OF TAX AND SOCIAL SECURITY PAYMENTS FOR
INDEPENDENT WORKERS IN CHILE**

Over the past decade, Chile has brought independent workers into pensions and social security by integrating contributions into the annual income tax process. The 2008 pension reform (Law 20.255) established the legal obligation of independent workers to contribute. In 2013, an opt-out auto-enrollment mechanism was introduced: by default, a portion of workers' income tax refunds was automatically redirected to individual pension accounts. However, roughly 90 percent of eligible workers opted out of the automatic enrollment annually, indicating that behavioral inertia alone was insufficient in the face of financial constraints (Azuara et al. 2021). In 2019, Law 21.133 made contributions fully mandatory for workers earning above five times the monthly minimum wage, covering pensions, disability, and health insurance.

Each April, when independent workers file taxes, Chile's internal revenue service (Servicio de Impuestos Internos, SII) calculates and withholds the required social security contributions from any tax refund or adds to their tax bill in case the tax refund is insufficient. Contributions are calculated on a base wage of 80 percent of the worker's prior-year gross income. To ease the transition, the system first leveraged an existing 10 percent tax withholding and gradually redirected it toward social security contributions. Workers could choose between "full coverage" (full benefits immediately) and "partial coverage" (contribute a smaller percentage of income to pension accounts) during the phase-in. In practice, partial contributors get full health and disability coverage from day one, but a smaller portion of their withholding goes into their pension fund initially (only about 3 percent of income in 2019), with that portion growing over time. Importantly, this design was underpinned by a noncontributory old-age floor (*Pilar Solidario*, now *Pensión Garantizada Universal* [PGU]), so those who cannot voluntarily contribute still have coverage at older ages. Following the voluntary rollout, Chile's mandatory policy included exemptions for individuals below a certain income threshold or above a certain age, recognizing that not everyone could afford to contribute.

FIGURE 8.4 INDEPENDENT WORKERS CONTRIBUTING TO THE PENSION SYSTEM



Source: Series Estadísticas del Sistema de Pensiones de Chile.

Even with the high opt-out rates, the automatic refund-to-pension scheme did manage to increase the number of contributors by 71 percent during the auto-enrollment years (2013–2018). Once contributions were made mandatory in 2019, nearly all eligible workers started contributing to social security. From 2018 to 2019, nearly 100,000 independent workers who were previously not contributing were integrated into the social security system.

Reducing reliance on payroll taxes to finance social security has significant fiscal implications and therefore requires careful consideration of alternative funding sources.

In Latin America and the Caribbean, payroll taxes account for approximately 16 percent of total tax revenue on average, reaching as high as 24 percent in Brazil (Rodríguez and Fernández 2023). Closing the resulting financing gaps will require reforms that expand fiscal space and mobilize new sources of revenue. As discussed in Chapter 7, for example, the United Kingdom and Finland have recently reduced social security contributions while offsetting the resulting revenue losses through increases in personal income taxes. If properly designed, a shift from payroll taxes toward more direct forms of taxation can also have positive redistributive effects. Recent evidence from 10 Latin American and Caribbean countries shows that, under plausible tax-incidence assumptions, payroll taxation increases poverty in every country analyzed (Pessino et al. 2025). Poorly designed alternatives, however, can undermine the very objectives these reforms seek to achieve. Substantial increases in corporate taxation, for

example, may reduce demand for formal employment, while poorly designed consumption taxes can have adverse distributional effects. Because these trade-offs extend beyond the scope of this book, we highlight several potential approaches rather than providing a comprehensive analysis.

- i. One such approach is to define clear boundaries for what the social protection system covers with public funds. Universal health coverage, for example, is costly and will become even more so with aging populations and rising medical technologies. Establishing clear limits on publicly funded coverage is therefore essential for fiscal sustainability. The same issue arises with pension benefits, which are often costly due to implicit subsidies that effectively provide higher pensions to wealthier individuals. For example, defined benefit pension schemes are structured to deliver benefits that, on average, are about 63 percent above what would be actuarially fair given contributions. In practice, these subsidies are largely captured by higher-income, formal workers. In Paraguay, for instance, the top three income deciles receive 70–95 percent of pension subsidies (Altamirano et al. 2023).
- ii. Expanding fiscal space can also be achieved by phasing out inefficient subsidies. Energy subsidies are a well-documented example: they are often environmentally harmful, fiscally costly, and disproportionately beneficial to higher-income households. Between 2020 and 2025, governments in Latin America and the Caribbean spent an average of US\$43 billion a year on energy subsidies, with some countries allocating nearly 3 percent of GDP to these programs. Yet only an estimated one in five dollars reached households that actually needed the support (Pessino, Astudillo, and Balza Angulo 2025).

Gradual reforms are feasible. Jamaica, for example, shifted from a universal electricity subsidy to one that excluded the richest 20 percent of households, cutting costs by 45 percent. Moving from broad subsidies to targeted cash transfers for the poorest half of the population could reduce costs by up to 64 percent while improving equity (Tesliuc, Paffhausen, and Avila 2024). Argentina's energy subsidy reform likewise strengthened fiscal sustainability while protecting vulnerable households (IDB 2024). In 2023, Argentina spent US\$10 billion on energy subsidies; its reform reduced subsidy coverage for high-income households from 60 to 7 percent, while coverage for the poorest households fell much less, from 94 to 74 percent. Overall, the reform generated fiscal savings exceeding 4 percent of GDP, with inefficient public spending declining from 7.2 to 3.5 percent of GDP between 2016 and 2024—nearly half of which is attributable to the reform (Pessino, Astudillo, and Balza Angulo 2025).

- iii. Reducing exemptions in personal and corporate income taxes can not only offset revenue losses but also promote fairness and reduce economic distortions. This approach was applied in Colombia's 2012 tax reform, which, as noted earlier, lowered employer contributions for health, family subsidies, and training. It also compensated for the revenue loss by increasing corporate taxes, primarily through a reduction in exemptions, thereby broadening the tax base.
- iv. Exploring new, less distortionary revenue sources, such as a dismissal tax, is also a promising approach. Beyond generating funds for unemployment insurance, a dismissal tax can help curb excessive layoffs. Replacing a payroll tax—wholly or partly—with this measure may improve both efficiency and equity. For instance, estimates for Bolivia, Colombia, Ecuador, and Peru indicate that such a tax could finance at least 25 percent of the total cost of an income protection program for dismissed workers (González-Velosa and Robalino 2020).
- v. Finally, a key area for reform is the revision of special tax and social insurance contribution regimes that vary by firm size, so as to eliminate incentives for strategic behavior. As discussed in Chapter 4, these regimes can create threshold manipulation: firms near the eligibility cutoff may deliberately remain small, constraining job creation, or split into multiple entities to retain preferential treatment, limiting the tax base even as total business activity grows. These preferential regimes may also encourage unregistered or semi-formal firms to underreport activity to stay below thresholds, further reducing collected taxes. Additionally, such regimes increase complexity and compliance gaps, as unclear rules can lead to misclassification and unintended tax avoidance (Azuara et al. 2019). They are also likely to exacerbate the problem of allocative inefficiency, by encouraging more labor and capital to go to small, less productive firms, as well as discouraging these firms from growing to an optimal size.

A final point worth noting is that a gradual but decisive shift toward a social protection system with less reliance on employer-employee contributions would not only expand income support to more workers but also lessen the burden of risk management in employment protection legislation (EPL). Since people would receive adequate support during income shocks and transitions, there would be less need for legislation that emphasizes stability. Rather, the focus of labor policy could also be on facilitating smoother transitions between jobs and reducing barriers to mobility. Over time, this approach could strengthen both individual protection and overall labor market efficiency, while lowering the administrative and enforcement costs associated with rigid employment rules.

D) Minimum Wage Policy: Balancing Protection, Productivity, and Pragmatism

As discussed in Chapter 4, minimum wage policies generally serve two main purposes. The first is to safeguard workers' living standards through decent pay. The second is to promote a fairer alignment between wages and productivity, so that workers' compensation more closely reflects their contribution to production. Although related, these objectives are distinct. The first depends on a socially acceptable threshold, which can vary considerably across countries and over time. The second is contingent on labor market imperfections that keep wages below productivity levels and on the existence of productive firms that can redistribute gains between employers and employees.

Minimum wages are thus a complex policy instrument combining multiple objectives, with their effectiveness depending heavily on institutional and market conditions. Unsurprisingly, the empirical evidence on the impact of minimum wage adjustments on inequality and labor market outcomes is mixed. Even so, several lessons from international experience and research provide useful guidance for institutional design.

Minimum wage levels should be grounded in economic realities and enforcement capacities to ensure they serve as an effective protection tool rather than a purely aspirational benchmark.

Minimum wages are intended as a redistributive tool, ensuring that low-paid workers receive a minimum level of earnings for a decent standard of living. Setting them too low is clearly inadequate, as it fails to prevent poverty. However, setting them too high can generate unintended consequences, such as informality or unemployment. It is therefore important to recognize that the impact of minimum wages on worker welfare depends on three core factors. First, it depends on the structure of the labor market: the redistributive effect is stronger in economies with a larger share of salaried workers in formal firms with market power and a smaller proportion of low-income self-employed workers (Levy and Cruces 2021; Gindling and Ronconi 2025). Second, it depends on the state's enforcement capacity: without credible monitoring and sanctions, minimum wages function largely as a

In many Latin American countries, minimum wages are set too high relative to labor productivity—often at or above the median earnings level—generating significant negative effects on formality.

reference point. Third, it depends on the level of the minimum wage in comparison to the country's wage distribution. In many Latin American countries, minimum wages are set too high relative to labor productivity—often at or above the median earnings level—generating significant negative effects on formality, even in contexts with monopsonistic labor markets.

The minimum wage should not be used as a numeraire or base value for social policy parameters. In many countries, the minimum wage serves as a reference for defining minimum living standards and is often used to adjust social protection benefits, fines, or other entitlements. This extended use can divert the minimum wage from its fundamental purpose and complicate adjustments. For example, when pension benefits or social transfers are indexed to the minimum wage, increases raise government expenditures, making adjustments less likely even when purchasing power erodes. Moreover, widespread indexation amplifies the inflationary and fiscal risks associated with minimum wage adjustments.

Recent experience in Colombia following a large real increase in 2025 illustrates this point. Because price ceilings and subsidies for social-interest housing are indexed to the minimum wage, the increase has reduced affordability and distorted the design of subsidized housing policy. Moreover, as higher minimum wages automatically raise pension floors, the 2025 increase has significantly raised the fiscal cost of the public pay-as-you-go system and increased the contribution requirements needed to finance a minimum pension in the individual account system. Thus, due to indexation, the large minimum wage increases in Colombia have posed risks to fiscal sustainability, pension coverage, and the affordability of subsidized housing.

Limiting the use of the minimum wage to its core function—as a labor market instrument rather than a numeraire for indexing prices or social entitlements—allows for more transparent and evidence-based negotiations. Mexico provides a good policy example. As discussed in Box 8.8, a constitutional reform that transferred the minimum wage's role as a reference for other payments to a new unit of measurement enabled a recovery in real minimum wages without creating negative impacts on employment.

BOX 8.8 MINIMUM WAGE POLICY IN MEXICO

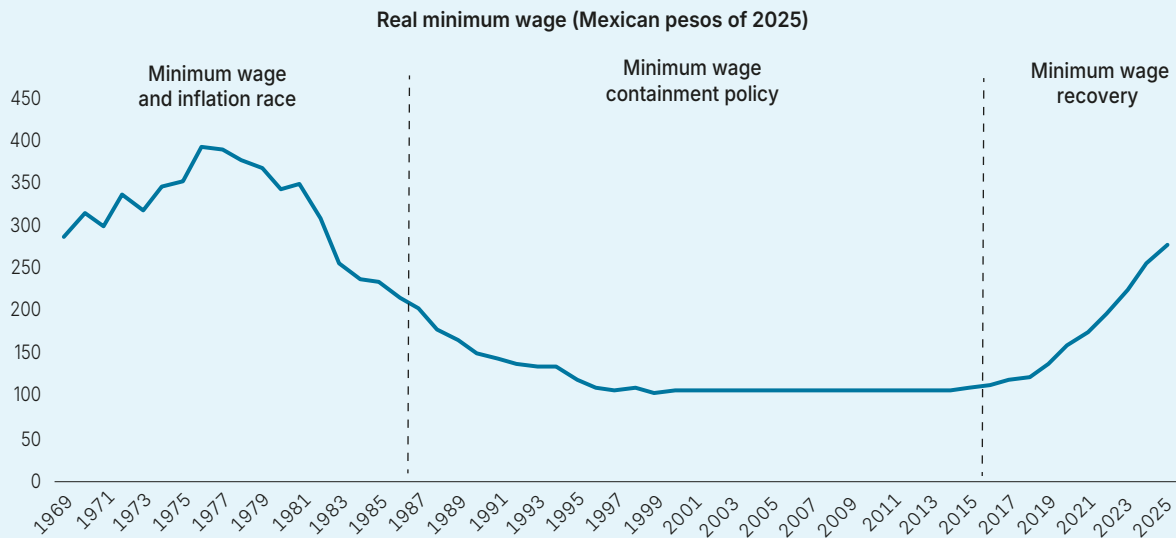
Since 2016, Mexico has applied a new method to set yearly minimum wages, allowing an increase in its value in real terms without detrimental impacts on employment, informality, and prices. This followed nearly three decades of deliberate containment of the minimum wage to combat hyperinflation, decreasing its value by 46 percent between 1987 and 2014. As the minimum wage containment policy persisted beyond its original objective to control hyperinflation, concerns grew that it negatively impacted the efficiency and equity of the labor market (Fairris, Popli, and Zepeda 2008; Bosch and Manacorda 2010; CDMX 2014). At the same time, there was the concern that high increases would revive the hyperinflationary periods of the 1980s (Banco de México 2016).

The 2016 reform addressed this through three simultaneous steps.

- i) The approval of a constitutional reform prohibiting linking the minimum wage to other prices unrelated to wages.
- ii) The creation of the Unit of Measurement and Update (UMA for its acronym in Spanish), which would replace the minimum wage in price setting. The annual value of the UMA would be published by the National Institute of Statistics and Geography (INEGI) and adjusted by the Consumer Price Index.
- iii) The creation of the Independent Recovery Amount (MIR for its acronym in Spanish) that seeks to restore workers' purchasing power. The MIR is determined yearly in absolute terms by Mexico's National Minimum Wage Commission (CONASAMI), a tripartite organization, and has been applied in minimum wage setting since 2017.

The implementation of this new minimum wage policy allowed an increase of 147 percent in the real value of the minimum wage between 2016 and 2025, with no negative impacts on employment and positive impacts on labor income and poverty reduction (CONASAMI 2019; Campos-Vázquez and Esquivel 2020; Campos-Vázquez and Rodas Milián 2020). Between 2019 and 2022, the number of people in poverty decreased by 23.7 percent because of the minimum wage (Munguía Corella and Gómez Lovera 2023). However, there is evidence that the minimum wage increase at the northern border would have increased prices had it not been offset by a simultaneous value-added tax reduction (Calderón et al. 2023). Two factors explain why such an increase avoided detrimental aggregate effects. First, the original value was low. Second, there is evidence of high concentration in the labor market. Munguía Corella (2020) estimates that, due to monopsony, wages in the average labor market are 29.4 percent lower than in the least concentrated—and therefore most competitive—labor markets.

FIGURE 8.5 REAL MINIMUM WAGE



Source: Authors' calculations using information from the Secretariat of Labor of Mexico and INEGI.

Countries with complex minimum wage systems should gradually transition to simpler, more transparent structures complemented by collective bargaining to address sector- and occupation-specific needs.

As shown in Chapter 4, complex systems with multiple minimum wages are common in Latin America and the Caribbean, where several countries have more than 10, and in some cases more than 50, different minimum wage rates. However, a minimum wage should be well known, easily understood, and widely accepted as a social convention. While differential minimum wages may reflect variations in productivity across sectors, occupations, or regions, excessive complexity imposes costs by complicating enforcement and limiting workers' understanding of their rights. Moreover, the data required to justify differentiated adjustments—such as productivity or inflation differentials across regions, occupations, or sectors—are often unavailable. A gradual process of simplification is therefore advisable.

Minimum wage levels should be grounded in economic realities and enforcement capacities to ensure they serve as an effective protection tool rather than a purely aspirational benchmark.

However, this process must be gradually implemented. If all rates are leveled upward in the short term, negative effects on employment may result (Ham 2018). This occurred in Honduras when wage floors across categories were equalized—leading to a steep average increase of about 60 percent. Simplification should thus be a phased process balancing clarity and enforceability. For example, Mexico implemented a gradual unification of geographically differentiated minimum wage categories, which did not trigger negative effects on employment or formality (Campos-Vázquez, Esquivel, and Santillán Hernández 2017).

Simplification naturally implies that sector- and occupation-specific variations are not directly incorporated into minimum wage levels. But, in this regard, and as recommended by the ILO, collective bargaining is a better tool. First, collective bargaining goes beyond the minimum wage in protecting vulnerable workers, addressing a broader range of rights and benefits. Second, collective bargaining agreements can be tailored to the specific conditions of sectors or occupations, such as differences in market power or levels of formality. Third, it may foster greater ownership and engagement among both employers and workers than statutory minimum wages. In fact, statutory minimum wages that set detailed rates across numerous categories can discourage collective bargaining by reducing the incentive to negotiate (Vega Ruiz 2009).

Proper representation in the minimum wage setting process should be ensured, including voices from small businesses, the informal sector, and independent experts. Tripartite arrangements—comprising government, employers, and workers—often privilege large firms and formal-sector workers, leaving out considerations of impact on small businesses and informal workers. In addition, economic analyses of trade-offs are not always well integrated into the process. Ensuring balanced representation, including small firms and independent technical experts, can help address these gaps and strengthen both legitimacy and evidence-based decision making. The United Kingdom's Low Pay Commission offers a good example: it includes three employer representatives (including small business voices), three employee representatives, and three independent experts. Its balanced composition has earned it wide credibility, with the result that recommendations are typically adopted by the government. Similar arrangements exist in Germany, Ireland, and South Korea (Dickens 2023; Low Pay Commission n.d.; Minimum Wage Commission n.d.).

Importantly, these commissions also conduct research on the impacts of minimum wage adjustments across a wide range of outcomes. This is crucial because, as noted earlier, such effects are often ambiguous, context-specific, and can extend beyond the labor market to broader general equilibrium impacts. In Latin America, Mexico's National Minimum Wage Commission (CONASAMI) has adopted similar good practices, recently investing heavily in data analysis and labor market research to guide its decisions.

In countries with statutory minimum wages, adjustments should follow clear processes and rules that incorporate technical criteria and provide predictability and clarity regarding their objectives. These frameworks can range from rigid formulas to more flexible procedures that allow for negotiation. There are trade-offs involved, and what works best will depend on the economic and social context as well as the structure and level of the minimum wage. Regardless of the approach, it is crucial to avoid a complete absence of formal rules, which leads to ad hoc, unpredictable, or politically driven decisions. This concern has been raised by advocates for a formula-based approach in Peru, where minimum wage adjustments do not follow a periodic schedule or a rule-based indexation formula but instead rely on a more reactive and discretionary model, typically led by the government with inputs from a tripartite body. This approach tends to be less predictable and more dependent on ad hoc decisions.

Countries use a wide range of approaches to set minimum wages.⁵⁵ One is to establish an automatic adjustment formula that updates the minimum wage according to a predetermined schedule (e.g., annually or biennially). This can have clear advantages: formulas enhance predictability for both employers and workers and prevent political or legislative delays. Adjustments may occur frequently and, under standard macroeconomic conditions, will generally be small, minimizing job dislocation costs. In these cases, formulas can be designed to rely on two main types of parameters:

- **Formulas linking adjustments to changes in the cost of living and productivity**, as in the cases of Costa Rica, Brazil, Colombia, and Ecuador. In principle, combining inflation and productivity growth indicators is justified to balance the objectives of preserving workers' living standards and sharing productivity gains. Adjustments for changes in the cost of living are typically based on past inflation, although some countries—such as Poland—use projected inflation and later correct for differences between forecasted and realized rates. Nevertheless, the greater technical challenge usually lies in accurately measuring productivity growth, as estimates are sensitive to data limitations, sectoral heterogeneity, and methodological choices (e.g., whether to use labor productivity, total factor productivity, or sector-specific indicators). In many contexts, high levels of informality and weak statistical systems further complicate measurement, potentially leading to biased or volatile estimates. It is therefore highly recommended to maintain transparency in the methodologies used to measure productivity and to periodically review and update the models.

55. See, for instance, ILO 2023; Dickens 2023; ILO 2022.

- **Formulas linking adjustments to the median wage**, as done in the United Kingdom, where the target is set at 60 percent of the median wage. The theoretical rationale is that linking adjustments to the wage distribution increases their effectiveness in reducing wage inequality. It may also ease the adjustment process, since the proportion of workers earning the minimum wage remains relatively stable. This approach has practical advantages as well, such as avoiding subjective debates around “living wages” or technical disputes about productivity measurement. However, it also entails trade-offs, including dependence on the quality of wage data and the fact that changes in the wage distribution may not fully reflect productivity dynamics. When using this approach, the minimum wage should be indexed to the median wage rather than the average wage, which can be skewed upward by a few outliers.

Regardless of whether formula-based adjustments are tied to productivity and inflation, or median wages, it is important to recognize that very rigid formulas can be costly and should be avoided. Moreover, good practice is to incorporate triggers that allow the formula to be modified in exceptional circumstances. For example, in economic downturns, adjustments could be zero or negative if unemployment and informality are excessively high. Similarly, high inflation poses a risk: automatic minimum wage indexation to prices can trigger a wage-price spiral in certain contexts. In this regard, Costa Rica provides a good example. Adjustments are not applied during periods of high inflation or economic downturns in key sectors such as agriculture, commerce, and construction. Such a trigger could have been useful in Colombia, where a large increase in the real minimum wage was adopted in 2020 during the COVID-19 pandemic, despite substantial losses in formal employment, and again in 2025, when the minimum wage was raised by nearly four times the rate of inflation even though productivity growth was low.

Importantly, the formulas should complement, not replace, negotiations. In fact, formulas can be deliberately designed to facilitate negotiation rather than constrain it. Instead of producing a single fixed adjustment, a formula can define a range, with lower and upper bounds, for the minimum wage increase. For instance, a formula could include rules specifying that adjustments be set at inflation plus or minus a percentage of productivity growth. In this way, the objectivity and technical rigor of the formula are maintained while explicitly creating space for negotiation.

Countries may choose to opt out of using formulas altogether. However, even in such cases, they should ensure clarity and transparency in the processes and criteria guiding the timing of minimum wage adjustments. They should also ground decisions in objective variables such as productivity growth, inflation, and employment conditions. This could be attained by having

explicit rules stating, for example, that minimum wages should not fall below the national poverty line or exceed the country's median wage, should not increase by more than a specified amount in a single adjustment, and should not grow faster than the sum of changes in the consumer price index and labor productivity.⁵⁶

The minimum wage should not be used as a threshold to access social protection entitlements, since doing so undermines both coverage and enforcement.

As discussed in Chapter 4, the minimum wage is often treated not only as a wage floor but also as a threshold for eligibility to contributory social programs, a practice with multiple drawbacks. First, it creates enforcement challenges. Workers' incomes are often volatile, causing their obligations and entitlements to fluctuate in ways that are difficult to monitor. This also generates stark discontinuities in effective contribution rates and strong incentives to underreport earnings. In Colombia, for example, self-employed workers are required to contribute to social security only if their income surpasses the minimum wage, encouraging declared earnings below that threshold. Perhaps even more importantly, using the minimum wage as an eligibility threshold can substantially limit coverage. In countries such as Ecuador, Honduras, Mexico, and Peru, self-employed workers may contribute voluntarily, but contributions are calculated based on at least the minimum wage, effectively excluding those earning less (Levy and Cruces 2021). This problem is particularly acute in countries where the minimum wage is relatively high in the earnings distribution, leaving many workers outside contributory social protection.

E) Revitalizing Collective Bargaining for Modern Labor Markets

Unions and collective bargaining systems can play a key role in reducing inequities and protecting workers from arbitrary decisions and unsafe working conditions. They can also facilitate social dialogue, fostering cooperation and reducing conflict. However, as discussed in Chapter 4, their reach and influence in Latin America and the Caribbean has been limited. Three main factors help explain this. First, union representation remains low. Second, in some countries, unions have expanded their influence into areas such as education or energy policy, diverting attention from their core mission of protecting workers' conditions. Third, a lack of trust among citizens persists: surveys in the region show that while people recognize the importance of unions, many continue to mistrust these institutions.

⁵⁶. See, for instance, ILO 2023.

Despite these limitations, a large majority of people in the region still view unions as necessary institutions to protect workers from abuses of power (Ronconi 2021). Moreover, as mentioned in Chapter 4, collective bargaining has a key advantage over minimum wages: it can adapt wage adjustments and other worker demands to the economic realities of each firm, sector, or region in a way that minimum wages cannot. A promising agenda to strengthen worker representation should focus on several key areas described below.

Strengthening internal governance and representativeness can have an important impact on equity.

Unions should adopt clearer and more transparent procedures for selecting representatives and managing mandates, finances, and elections, thereby strengthening internal democracy and accountability. They should also ensure adequate representation of all segments of workers. A relevant example comes from Brazil, where a trade union federation increased women's representation in leadership positions. Rigorous evidence from Corradini et al. (2022) shows that these changes improved workplace amenities valued by women (including more female managers, longer maternity leave, and stronger job protection) and had no adverse effects on employment, wages, or firm profitability (see Box 8.9). More generally, these results suggest that stronger and more inclusive representation can improve the treatment of traditionally underrepresented groups without compromising productivity. A promising step in this direction is Mexico's 2019 labor reform, which introduced requirements for women's representation in union leadership to be proportional to their share of union membership.

Collective bargaining has a key advantage over minimum wages: it can adapt wage adjustments and workers' demands to the economic realities of each firm, sector, or region in a way that minimum wages cannot.

BOX 8.9 PROMOTING WOMEN'S LEADERSHIP IN UNIONS: EVIDENCE FROM BRAZIL ON FEMALE-CENTRIC BARGAINING

Corradini, Lagos, and Sharma (2022) study an interesting case in Brazil in which leaders at the largest trade union federation were encouraged to prioritize women's needs in collective bargaining. Starting in 2015, this federation reserved half its leadership positions for women and prioritized female-centric policies in bargaining. By tracking labor transitions and linking them with the characteristics of collective-bargaining agreements, the authors found four sets of results.

First, women value amenities that help strike a work-life balance, including maternity protections, childcare payments, and policies for dependents, absences, and workday reductions. Men, on the other hand, value better pay and safer work conditions, including profit sharing, hazard pay, life insurance, and safety equipment. Second, female-centric amenities increased because of the reform. In contract terms, female-centric amenities rose by 19 percent in treated contracts relative to comparison contracts. After the reform, women were more likely to be managers, take longer maternity leaves, and enjoy job protection even after extending their maternity leaves. No changes were observed in the workplace environment to suggest that men were worse off (e.g., workplace injuries did not increase). Third, retention of women employees increased 1.8 percent, driven mostly by a drop in voluntary separations, and women's share among probationary workers—a proxy for the share of women among job applicants—rose 1.7 percent. Interestingly, the retention of male employees in treated establishments also increased—although less than among female employees—suggesting that men also value the “female-friendly” changes. Fourth, these positive changes in female-centric amenities did not have any negative effects on wages, overall employment, profits, or the probability of establishment exit.

Thus, promoting female leadership in unions may be beneficial for women's labor market outcomes. Interestingly, the 2019 labor reform in Mexico requires women's representation in union leadership to be proportional to the female share of union membership.

Ensure the impartial enforcement of labor laws for both employers and unions to maintain a fair and effective system of collective bargaining.

Labor codes in all countries establish the rules that employers and unions—or groups seeking to form unions—must follow. They generally guarantee, at least in law, workers' rights to organize and to engage in collective bargaining. Governments therefore have an obligation to enforce these rules and to sanction employer violations that undermine workers' fundamental rights. But, at the same time, labor legislation does not grant unrestricted discretion. For instance, while strikes are permitted in most legal frameworks, they are typically subject to clearly defined conditions, such as demonstrating support among union members, pursuing legally recognized objectives, clearly articulating demands, and providing adequate notice to employers. Union activities are regulated in many other respects as well. Just as violations of collective bargaining rights by employers should be sanctioned, breaches of labor legislation by unions or union leaders should also be subject to enforcement.

In this regard, the case of Mexico is interesting, precisely because further adjustments may be necessary to effectively enforce the democratic processes within unions contemplated in the 2019 labor reform. During the implementation of the reform, many voices, including the newly created federal center charged with supervising union democratic processes (Martínez 2025), asked for increased sanctions for violations of procedures that ratify collective bargaining arrangements and are used to select union leadership. Importantly, these sanctions would be applied both to employers and to unions that violate the democratic processes. A bill was presented along these lines, which was approved by the lower chamber of Congress, and it is pending approval by the upper chamber.

Thus, aiming for a balanced approach can help preserve collective bargaining as a process of good-faith negotiation between employers and workers' representatives. While negotiations often lead to mutually beneficial outcomes, conflict may arise, in which case the role of government is to ensure that the rules of the system are respected and applied impartially, without favoring either party.

Unions need stronger capacities to adapt to the modern economy. This includes promoting platform-specific collective agreements that establish clear rules on pay, employment status, and protections at the company level where feasible. Denmark provides a prominent example: unions there have negotiated collective agreements with platform companies that explicitly define when platform workers are treated as employees and which protections apply. These agreements set minimum wages, access to paid leave, social security contributions, and rules governing working time and dismissal. Importantly, they also specify the conditions under which workers transition from independent contractors to employee status, creating clearer

rights for workers while providing platforms with legal certainty. Rather than relying exclusively on statutory reforms, court rulings, or broad legislative reclassifications that may not fit all firms or contexts, firm-specific agreements can offer practical and enforceable solutions tailored to individual platforms (OECD 2019).

Broaden representation to new and underserved workers and forge new alliances. Unions should make greater efforts to engage younger workers and those in emerging labor markets, such as platform-based or gig work. Many of these workers lack effective advocates. Innovative forms of organized labor—such as worker centers, online collectives, and hybrid associations—can help fill this gap. In some cases, unions may need to form alliances with other organizations to reach dispersed or informal workers. Collaborations with civil society organizations—such as NGOs, legal aid groups, migrant support organizations, and intermediary agencies—can help unions extend protection to vulnerable groups, including informal and migrant workers who remain outside standard collective bargaining structures.

As discussed in Box 8.10, a well-documented example comes from the UK cleaning sector, which is dominated by migrant workers, often from racial minorities, and characterized by widespread outsourcing and precarious employment. In this context, trade unions deliberately partnered with community-based NGOs and migrant support organizations to overcome fear, language barriers, and legal exclusion that had long prevented effective worker representation.

Strengthen the role of unions in labor law enforcement. Unions can support compliance by monitoring and reporting violations, as well as by educating workers about their rights. For example, Amengual and Fine (2017) describe how workers' organizations in Argentina cooperated with provincial labor inspectors to implement co-enforcement mechanisms, enhancing compliance capacity. However, as noted by Ronconi (2021), safeguards are needed to prevent regulatory capture—when unions influence inspection agencies to focus enforcement only on firms employing their members, leaving informal workers unprotected.

BOX 8.10**EXTENDING UNION PROTECTION THROUGH CIVIL SOCIETY ALLIANCES: THE JUSTICE FOR CLEANERS CAMPAIGN IN THE UNITED KINGDOM**

The *Justice for Cleaners* campaign in the United Kingdom illustrates how collaboration between trade unions and civil society organizations can extend labor protection to vulnerable workers who remain beyond the reach of traditional union organizing. The cleaning sector in the UK is characterized by extensive outsourcing and high levels of precarity and is dominated by migrant and racialized workers, many of whom face language barriers, insecure immigration status, and fear of retaliation. To overcome these constraints, trade unions partnered with community-based and faith-based organizations, migrant and women's associations, and legal-aid and worker-rights NGOs. These actors played complementary roles. Civil society organizations acted as trusted entry points, providing language support, cultural mediation, and safe spaces for workers who would not initially approach unions. Legal-aid partners supported claims related to wage theft, unfair dismissal, and abusive employment practices, while unions translated individual grievances into collective bargaining demands and coordinated labor action.

Over time, these partnerships were formalized through *Cleaners United*, a national coalition designed to integrate collective bargaining capacity with legal assistance, immigration advice, and community organizing. This hybrid model produced concrete outcomes. Campaigns secured living-wage agreements, improvements in sick pay and holiday rights and, critically, the insourcing of previously outsourced cleaning workers at universities and other public institutions. The experience demonstrates how civil society alliances can complement unions' institutional strengths and significantly broaden the reach of worker protection and collective bargaining in highly fragmented labor markets (Holgate 2015).

8.2.2 From Rules to Enforcement: Building Credible Labor Institutions

A) Effective Enforcement

There are numerous examples of aspirational labor regulations that remain largely unenforced. As documented throughout this book, large shares of workers earn less than the minimum wage, a problem driven not only by regulatory design shortcomings but also by insufficient or poorly structured enforcement. Strengthening enforcement capacity is therefore essential, and progress is needed along several fronts.

Labor inspectorates and social security enforcement agencies should adopt risk-based and data-driven approaches.

The technical independence of inspection and enforcement agencies must be safeguarded. As discussed in Chapter 4, political incentives can lead to weak or selective enforcement. When regulations are overly stringent, governments may deliberately overlook violations to avoid political backlash, and enforcement efforts may become arbitrary or politically motivated. Beyond improving institutional capacity and resources, governance reforms are required to ensure that enforcement bodies operate with professional autonomy and are as insulated as possible from political interference. Measures to support this include independent budget authority, merit based appointment processes supported by robust civil service protections, and advisory boards with multi-stakeholder representation—employers, unions, academia, civil society, and government—that, while not involved in day-to-day management, can help monitor technical independence and reduce the risk of unilateral political influence.

Social security enforcement agencies and labor inspectors should establish structured mechanisms for collaboration and coordination, both among themselves and with tax authorities. Such coordination is essential for at least two reasons. First, these areas are closely interconnected: noncompliance in one domain often signals or generates risks in the others—for example, underreporting wages affects not only tax collection but also labor protections and social security contributions. Coordinated efforts allow authorities to identify violations more efficiently, share relevant data, and implement joint inspections, increasing overall compliance. Second, collaboration strengthens the credibility and deterrence effect of enforcement, making it more difficult and costly for employers to circumvent obligations. An important initial step is the integration and coordination of information systems, as discussed previously, to facilitate data sharing and joint monitoring.

Labor inspectorates and social security enforcement agencies should adopt risk-based and data-driven approaches.

Many agencies still operate reactively, but shifting toward targeted, evidence-based enforcement offers at least three major benefits. First, data-driven models allow inspectorates to concentrate resources on sectors, firms, and behaviors with the highest likelihood of noncompliance, improving efficiency. Second, they create greater transparency by providing objective criteria for why certain firms or sectors are prioritized. Implementing these systems typically requires integrating tax, social security, migration, and payroll data to generate risk profiles for firms; using algorithms to detect suspicious patterns (e.g., zero-payroll firms, repeated short-term contracts, identical hours across multiple contracts, abrupt mass layoffs); prioritizing inspections based on compliance histories and risk scores; and equipping inspectors with digital dashboards that provide real-time alerts and recommended targets.

Several countries have advanced significantly in this direction. In Spain, major efforts over the past decade have focused on consolidating an integrated information system that simultaneously supports agencies responsible for enforcing social security obligations, detecting labor law violations, and combating fraud. This system—*herramienta de lucha contra el fraude*—uses advanced analytics to identify and predict fraudulent patterns through the large-scale processing and cross-referencing of data. A key strength is the legal and institutional framework that enables extensive information sharing across multiple internal and external sources. The *Inspección de Trabajo y Seguridad Social* (ITSS) uses this system to guide inspection strategies, improving not only the monitoring of historical risk patterns but also the early detection of emerging forms of noncompliance, thereby increasing the likelihood of timely corrective action.⁵⁷

Mexico is moving in a similar direction. The Secretariat of Labor and Social Welfare is promoting the *Sistema de Inteligencia de Datos para la Inspección Laboral* (SIDIL), which will integrate, process, and analyze multiple internal and external data sources to generate predictive assessments of the probability of noncompliance for each registered workplace. These probabilities will be assigned directly to establishments in the *Directorio Nacional de Empresas* (DNE), allowing the authority to prioritize those with the highest risk. Through this system, focused “high-risk universes” of firms will be generated to support the design and execution of more precise and effective inspection operations.⁵⁸

57. See, for instance: <https://indd.adobe.com/view/b2ae1354-cf6d-4e14-8ef9-9fc60e0ac1b0>.

58. See, for instance: <https://capacitacionstps.com/que-es-el-sidil-y-como-beneficia-a-las-inspecciones-laborales/>.

Strengthen incentives for compliance through simplified regulatory regimes and digitalization, while avoiding rules that impose lower costs on smaller firms and could discourage their growth. Enforcement alone is insufficient in highly informal economies; firms must also find formalization feasible and low-cost. In many countries, administrative procedures are so complex that they become prohibitive, particularly for small and medium-sized firms that lack dedicated human resources (HR) departments yet employ a nonnegligible number of workers. In Colombia, for example, formalizing a worker requires navigating multiple independent systems—EPS (health insurers), AFP (pension funds), ARL (occupational risk insurers), *Cajas de Compensación* (family allowance funds), DIAN (tax authority), and PILA (the unified contribution payment platform)—each with its own rules, platforms, and procedures. This fragmentation generates significant administrative costs, making compliance especially burdensome for smaller firms and increasing the likelihood of errors, delays, and eventual informality. Streamlining and integrating these processes would reduce compliance costs and encourage more employers to formalize workers by lowering both the informational burden and the time required to meet legal obligations.

In this regard, Brazil offers a strong example of meaningful progress. The country's eSocial⁵⁹ platform demonstrates how integrated information systems can substantially reduce administrative burdens and enhance compliance. eSocial consolidates into a single digital interface all employment- and work-related reporting requirements for labor, social security, payroll, and tax obligations—replacing more than a dozen separate forms previously submitted to different agencies (including the Ministry of Labor [Ministério do Trabalho e Emprego], the Internal Revenue Service [Secretaria da Receita Federal do Brasil], the Social Security Administration [Instituto Nacional do Seguro Social, INSS], and the Unemployment Insurance Fund [Fundo de Garantia do Tempo de Serviço, FGTS]). By standardizing data and enabling real-time reporting, the platform reduces transaction costs for firms and minimizes inconsistencies across registries. Moreover, storing all employment and work information in a central database can lower maintenance costs and facilitate oversight.

As detailed in Box 8.11, Peru has also made progress in this area through *SUNAFIL en Línea*, a digital platform developed by the National Superintendence of Labor Oversight (SUNAFIL, for its Spanish acronym). The platform offers 17 fully digital services, including filing labor complaints and verifying the identity of labor inspectors. Estimates suggest that within approximately 1.5 years of operation, the platform has saved almost 40,000 working days (full-time equivalent) in time previously spent on bureaucratic procedures.

59. See, for instance: <https://www.gov.br/esocial/pt-br>.

Importantly, simplified compliance measures should not disproportionately reduce regulatory costs for small firms, as this can create distortions that weaken incentives for firm growth. As discussed in Chapter 3, labor enforcement in the region in practice focuses primarily on large firms, with limited attention to small firms and almost none to unregistered establishments, thereby encouraging firms to remain small or informal to avoid scrutiny. Although enforcing labor regulations among small and unregistered firms is politically and technically challenging because of the widespread tolerance of informality and the difficulty of identifying these establishments, it remains socially important. Some of the most severe labor rights violations, including labor exploitation and child labor, are concentrated in this segment of the labor market. It is also economically important, since, as discussed in Chapter 3, there is evidence that weak enforcement based on firm size can effectively act as an implicit subsidy that discourages firm growth and productivity improvements.

Improve information and agency of workers and leverage behavioral insights. Workers often lack knowledge or understanding of labor laws, which limits their ability to assert rights or participate in enforcement processes. Providing low-paid workers with accessible information and increasing their agency can strengthen enforcement from the ground up. For example, in Costa Rica, the government established an anonymous tip line allowing workers to report labor law violations directly. Each complaint triggered an inspection, and the initiative was supported by an extensive public campaign informing the population about labor rights and how to act if those rights are violated (Gindling and Ronconi 2025).

Another notable example of increasing the agency of workers is *Verifica tu Chamba*, a digital tool that allows workers in Peru to verify whether they have been properly registered on their employer's payroll. As discussed in Box 8.11, when workers identify omissions, the labor inspection agency (SUNAFIL) sends an alert directly to the employer without disclosing the identity of the reporting employee. This mechanism lowers the cost and risk of reporting for workers while strengthening enforcement through timely, targeted action.

Relatedly, insights from behavioral economics offer promising avenues to improve compliance by recognizing that firms' decisions to comply with labor regulations are shaped not only by formal cost-benefit calculations but also by cognitive biases, social norms, heuristics, and limited attention. As discussed in Chapter 3, evidence shows that simple, low-cost interventions—such as framing messages to increase the salience of social security benefits in old age, highlighting peer compliance, or sending well-timed reminders—can meaningfully improve adherence to labor regulations. For example, SUNAFIL's use of carefully framed messages has increased worker enrollment in social security without changes in enforcement intensity. By combining better information for workers with behavioral insights, enforcement strategies can become more effective, participatory, and cost-efficient.

BOX 8.11

**MODERNIZATION OF LABOR INSPECTION AND OVERSIGHT:
THE CASE OF PERU**

In 2018, the National Superintendence of Labor Oversight of Peru (SUNAFIL, for its Spanish acronym) began a comprehensive digital transformation, aimed at establishing a fully digital inspection system. Three key developments supported its success. First, the bidirectional electronic mailbox between SUNAFIL and its users (workers and employers) has been essential in strengthening the preventive approach to labor oversight. Through this tool, notification times were drastically reduced from an average of 8 days to less than 30 minutes and the coverage of oversight services expanded significantly, with the number of notifications increasing from 1.5 million in 2020 to over 6 million in 2024. Second, the digitalization of its services—*SUNAFIL en Línea* and *SUNAFIL en tus Manos*—saved 18.7 million minutes in bureaucratic procedures, making it one of the most widely used government platforms in Peru. Third, the program *Verifica tu Chamba* allowed workers to verify whether they have been registered on their employer's payroll by simply entering their personal and company information. If any omissions are detected, SUNAFIL sends a confidential alert to the employer, urging them to regularize the worker's employment situation—without revealing the identity of the person who submitted the report.

The digital transformation process improved the overall efficiency and effectiveness of the inspection process, but important challenges remain. The average time to resolve a labor inspection—from the filing of a complaint to first-instance resolution—decreased from more than 500 days in 2018 to 467 in 2025. Likewise, the share of inspection orders closed within the legal timeframe increased from 57.1 percent in 2018 to 65.4 percent. *Verifica tu Chamba* has been effective in promoting labor formality. From the app's launch in 2021 through 2025, 749,141 workers were added to the electronic payroll system—that is, they were formalized. To continue improving the efficiency and effectiveness of labor inspection, it is important to devote more human and financial resources to consolidating SUNAFIL's transformation—as pointed out by the OECD's 2025 assessment report.

Invest in increasing the perceived value of compliance and strengthening institutional credibility.

While more effective enforcement is important, it is not sufficient on its own. The value that workers and employers assign to participating in formal systems is equally critical. When they recognize tangible benefits from compliance, they are more likely to engage consistently. This perceived value depends not only on the quality and design of the system, such as whether benefits from contributory schemes differ meaningfully from noncontributory alternatives as shown in Chapter 7, but also on actions that enforcement agencies can take. Clear communication of rights and obligations, combined with fair, transparent, and trustworthy enforcement, can significantly enhance both compliance and confidence in the institutions that administer these systems.

Strengthen enforcement to ensure that vulnerable populations can effectively exercise their labor rights and benefit from them.

These efforts should ideally follow a multipronged strategy that not only strengthens enforcement capacities but also updates and adapts regulations, simplifies administrative procedures, and actively communicates workers' rights and benefits. In this regard, Uruguay's comprehensive strategy for domestic workers offers an exemplary model. As detailed in Box 8.12, it combined a new regulatory framework that guaranteed labor rights, targeted improvements in labor and social security inspection, used tripartite collective bargaining to raise and differentiate wages, simplified social security enrollment tools, and extensively raised awareness through communication campaigns. Such an integrated approach is especially important when addressing sectors where informality, limited bargaining power, or work inside private households makes traditional enforcement more challenging.

BOX 8.12

**FORMALIZING DOMESTIC WORK: URUGUAY'S
COMPREHENSIVE POLICY FRAMEWORK**

In 2006, Uruguay implemented a multidimensional approach aimed at formalizing domestic workers, driven by strong political will. This approach entailed five main steps. First, a regulatory framework (Law No. 18.065) established the baseline by recognizing the labor and social security rights of domestic workers. It also incorporated domestic workers into the wage-setting system established by the Wage Councils, which helped them achieve key labor benefits such as a minimum wage, paid holidays and other bonuses, and a night work premium. Second, the Labor and Social Security Inspectorate (IGTSS) strengthened labor inspection systems through specific protocols for inspecting domestic work. The strategy relied on voluntary visits, accompanied by public information campaigns and inspector training, which made it possible to initiate ex officio inspections in households. Third, the authorities simplified social security registration for domestic workers through a dedicated webpage, chatbots, contribution simulators, and contribution billing, which provided crucial support for employers who may lack the expertise to make these calculations. Finally, Uruguay complemented these efforts through massive awareness campaigns about new rights and duties, and by providing free legal advice to domestic workers.

As a result of these efforts, the share of domestic workers contributing to social security increased from 38 percent in 2006 to 59 percent in 2023. Domestic workers worked an average of 3 hours less per week, and the share of domestic workers in total employment decreased from 9 to 6 percent during the same period, which could reflect an increase in labor costs as the average real wage doubled. Despite this, the number of domestic workers receiving a pension in old age increased by 47.5 percent between 2009 and 2023.⁶⁰

60. See: <https://www.bps.gub.uy/bps/file/21945/1/114.-trabajo-domestico-remunerado-en-uruguay.-avances-y-brechas-en-el-acceso-a-la-seguridad-social.-actualizacion.pdf>.

FIGURE 8.6 AVERAGE REAL WAGE AND HOURS WORKED OF DOMESTIC WORKERS (URUGUAY)

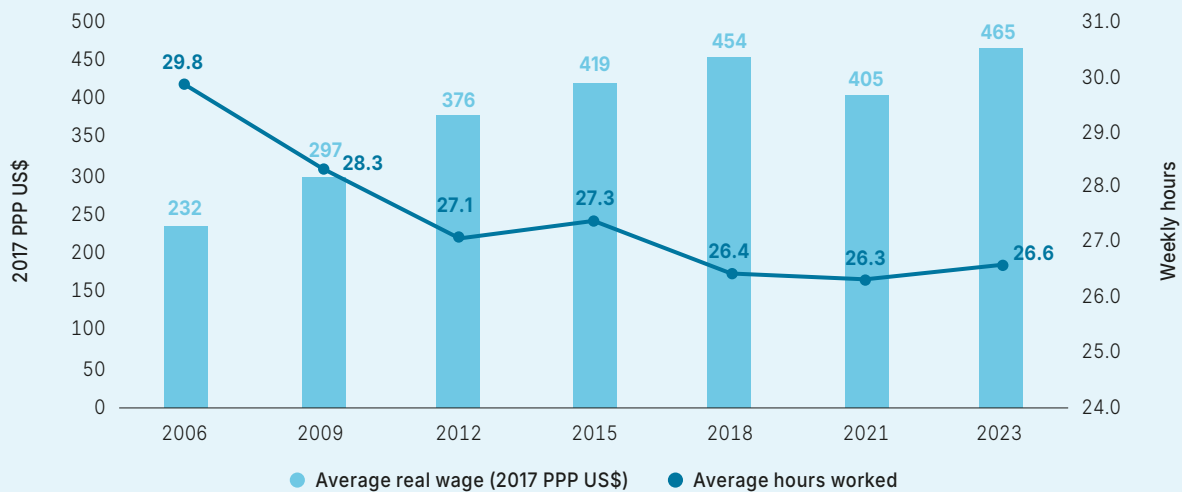
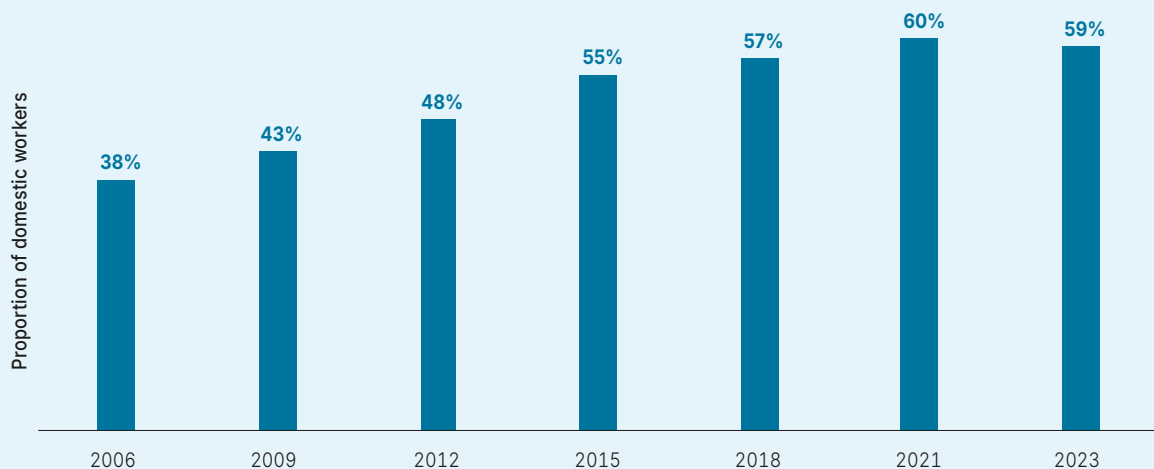


FIGURE 8.7 PROPORTION WITH SOCIAL SECURITY OF DOMESTIC WORKERS (URUGUAY)



Source: Author's calculations, based on IDB (2025), Harmonized Household Surveys of Latin America and the Caribbean.

Note: The definition of domestic workers follows ILO's Convention No. 189: any person engaged in work performed in or for a household within an employment relationship.

B) Enhancing Labor Justice: Incentives, Information, and Institutional Reforms

As discussed in Chapter 3, labor relations are not voluntary transactions between equals. Workers typically have less bargaining power than employers, and, unlike standard market exchanges, labor relations are ongoing and often marked by structural conflict. A central goal of labor policy is, therefore, to develop institutional capacities for the effective resolution of these conflicts. However, this goal is frequently undermined by several factors: perceived unfairness, limited state capacity, lack of access to legal remedies, and widespread distrust in the system. Survey data on labor disputes in Colombia illustrate these challenges: 61 percent of individuals who experience a justiciable labor conflict take no action to resolve it due to a lack of trust in the institutions designed to enforce labor rights (Ramírez Bustamante 2021). To enhance labor justice, several avenues of reform are discussed below.

In Colombia, 61 percent of individuals who experience a justiciable labor conflict take no action to resolve it, due to a lack of trust in the institutions designed to enforce labor rights.

Identify and revise elements of labor legislation that may unintentionally encourage excessive litigation. A relevant example is Mexico's 2012 labor reform, which aimed to clarify dismissal procedures and eliminate distortions that prolonged labor disputes. Under the previous legal framework, when a dismissal was contested, compensation to the worker accrued from the date of termination until the final judgment. This mechanism created strong incentives to extend litigation, often resulting in financial strain and prolonged uncertainty for both parties. The reform addressed this by introducing a cap on back pay of 12 months' wages, regardless of how long the dispute lasted. It also strengthened deterrents against procedural delays by increasing penalties for both employers and workers who intentionally obstructed the resolution process.

Ensure institutional competence and procedural clarity. Mexico's 2019 reform illustrates this point. Prior to the reform, labor disputes were handled by conciliation and arbitration boards, which were often ineffective and lacked standardized procedures. The reform transferred responsibility for dispute resolution to independent labor courts within the judicial branch, introducing greater impartiality, clearer procedures, and stricter enforcement. As a result, labor trials now follow defined procedural rules, improving both predictability and the overall quality of labor justice.

Of course, the transition to the judiciary came with trade-offs—most notably, the challenge of addressing case backlogs. Delays in the judicial system are common across Latin America. For example, in 2019, the largest labor court in Mexico City received approximately 35,000 filings and had a backlog exceeding 100,000 cases (Sadka, Seira, and Woodruff 2024). This underscores the importance of complementing institutional reforms with additional measures to manage demand, ensuring that resources are focused on relevant cases.

Internalize some of the costs of litigation in order to discourage groundless or opportunistic lawsuits. A relevant example is Brazil's 2017 labor reform. Prior to the reform, individuals could file labor claims at no cost simply by asserting an inability to pay. The reform introduced stricter requirements, such as the need to provide evidence of low income, and imposed penalties for meritless claims. In addition, it tightened the standards governing when plaintiffs can file and withdraw complaints, aiming to reduce strategic or opportunistic use of the judicial system. Evidence shows that these changes markedly reduced the volume and cost of labor litigation and may also have contributed to improvements in labor productivity (IMF 2024).

Provide workers with better information to significantly improve dispute resolution outcomes. Experimental evidence from a randomized controlled trial in Mexico's largest labor court shows the impact of offering workers personalized information on likely case outcomes. The intervention provided data on expected compensation amounts, case duration, and settlement probabilities. The study found that firms were typically the better-informed party, while workers were often overly optimistic and misinformed, frequently overestimating their chances of winning. Access to accurate, case-specific information increased settlement rates, shortened case durations, reduced court congestion, and left most plaintiffs at least as well off as they would have been otherwise (Sadka, Seira, and Woodruff 2024). These findings are consistent with earlier evidence by Kaplan, Sadka, and Silva-Méndez (2008), which showed that, after controlling for observable characteristics, workers who settled tended to fare better than those who pursued litigation.

Promote alternative dispute resolution (ADR) mechanisms such as conciliation to ease the burden on labor courts. Mexico's 2019 reform made a conciliation hearing mandatory before any lawsuit can proceed and created new public institutions dedicated to conciliation services. Similarly, Brazil's 2017 reform expanded opportunities for conciliation, aiming to reduce the number of lawsuits filed. Institutional support is also crucial in this area. For example, Argentina established a national mediation and arbitration agency in 2020 to strengthen its ADR framework. In Colombia, labor inspectors can act as conciliators, and recent data show high success rates: of all conciliations conducted between 2015 and 2019, 68 percent reached a total agreement and 10 percent reached a partial agreement (Ramírez Bustamante 2021).

Ensure adequate resources for the labor justice system. The preceding recommendations complement the fundamental requirement of ensuring adequate resources for the labor justice system—a necessity so evident that it often goes unstated. In Colombia, for example, the number of labor judges per capita is approximately 80 percent lower than the OECD average. Between 1993 and 2019, labor-related cases increased by 177 percent, while the number of labor judges remained unchanged (Ramírez Bustamante 2021). Mexico faces a similar challenge. While the effectiveness of union representation and the resolution of labor disputes have undoubtedly improved (ITUC 2026), progress has been somewhat constrained by institutional factors. Since the 2019 reform initiated a transition from conciliation boards to independent labor courts, the number of judicial actors has remained constrained relative to caseloads. In 2025 alone, approximately 66,000 cases were filed, to be handled by just 142 federal labor judges, in addition to 10 judges in the Federal Tribunal for Collective Labor Disputes. As a result, average resolution times are approximately seven months for individual disputes and more than four months for collective cases (Davis et al. 2023). Mexico's experience underscores why any reform must be grounded in a baseline of institutional capacity to effectively enforce labor law.

8.2.3 Developing Workforce Skills and Expanding Job Access

A) TVET Systems That Drive Growth, Inclusion, and Workforce Transformation

As discussed throughout the book, sustained improvements in workers' conditions require higher labor productivity. Technical and vocational education and training (TVET) contributes to this objective by strengthening workers' job-relevant skills and improving the match between skills and production needs. Moreover, by enabling continuous upskilling throughout working life, TVET also helps firms adjust to new technologies and production processes.

As described in Chapter 6, TVET institutions in the region have a long history. Since the mid-twentieth century, many countries have implemented a model of public provision through national training institutes, often linked to import-substitution industrialization strategies. Many of these institutes were established as sectoral or tripartite institutions and financed through payroll levies. Over time, the system expanded and diversified, with a broader range of modalities of instruction and provider types and the use of public subsidies to support private provision. The objectives of TVET also expanded beyond the training of industrial workers to the support of broader goals such as employability, social inclusion, and workforce adaptation to globalization and technological change.

Despite this evolution, TVET systems remain highly fragmented and organized in institutional silos. This partly reflects the fact that TVET sits at the intersection of multiple policy domains—education, labor, social protection, productive development, and trade—making coordination inherently complex. In many countries, it is difficult even to identify what is financed, by whom, and for what purposes. Data limitations further constrain evidence-based policy making, while weak quality assurance systems hinder the evaluation of results, particularly in terms of employability outcomes. These challenges are compounded by weak and uneven links with the private sector, as well as persistent human capital constraints, including shortages of qualified TVET instructors and trainers. Based on the analysis in Chapter 6, several policy recommendations emerge.

Strengthen governance and coordination mechanisms to align diverse actors around common objectives. This can include establishing permanent coordination bodies with clear mandates and internal governance arrangements to align responsibilities for formal, nonformal, and informal TVET across government agencies and across national and subnational levels. To avoid these bodies becoming mere “talking shops,” it is essential that they (i) be supported by legislation or binding agreements; (ii) operate under mandates aligned with political priorities; (iii) balance hierarchical decision making with collaborative governance; (iv) set clear objectives and are accountable for measurable results; (v) explicitly recognize trade-offs, such as those between skills policies aimed at productive development and those focused on social inclusion; and (vi) ensure meaningful participation of nongovernmental actors, including employers and workers, while applying safeguards against undue influence by special interests (OECD 2020; Levin et al. 2024).

A useful example in this regard is Germany’s Alliance for Initial and Further Training, which coordinates agencies at both the national and subnational levels and brings together representatives from the education, economic affairs, and labor portfolios. The alliance focuses on concrete, time-bound commitments, including agreements to integrate disadvantaged youth into the system through assisted apprenticeships and to support the integration of refugees into TVET pathways (OECD 2020; Levin et al. 2024).

Create credible incentives for sustained private sector participation.

This requires moving beyond consultation toward arrangements that give employers meaningful ownership and co-responsibility in skills systems. In practice, this often involves granting the private sector a greater role in the governance and management of skills funds, combined with explicit cost-sharing mechanisms. When employers contribute resources, they have greater “skin in the game,” which tends to strengthen engagement and improve the relevance of training provision.

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A well-known example is the model underpinning Germany’s dual apprenticeship system, which is built around a clearly defined cost-sharing arrangement between the state, firms, and workers. The states (i.e., Länder) finance vocational schools and colleges, as well as preparatory courses delivered in these institutions. The federal government covers most of the costs of firm-based preparatory qualification measures linked to labor market activation policies. Training firms, however, bear the largest share of overall financing by paying for the firm-based component of training. Workers, through their representative organizations, accept a degree of wage restraint for apprentices in exchange for the provision of training that builds skills with strong and recognized value in the labor market (Levin et al. 2024).

These underlying principles of shared financing, co-governance, and aligned incentives in the German model are transferable to other institutional settings. For instance, in Singapore, the *SkillsFuture* system combines strong public stewardship with substantial employer co-financing and firm-led training provision, aligning incentives by requiring employers to invest directly in workforce upgrading (Levin et al. 2024).

Invest in systems to identify skills demand and ensure that training provision aligns with labor market needs. All countries in the region make some effort to assess skills needs, often through studies or surveys focused on specific sectors. However, there are few examples in the region of integrated systems that combine multiple data sources and systematically capture labor demand information to inform training content. By contrast, several non-LAC OECD countries have invested in labor market information systems that integrate data on vacancies, wages, occupations, skill requirements, and employment outcomes. These systems draw on multiple sources—including household and labor force surveys, administrative records, education and training providers, employer surveys, and more granular data from consultations with sectoral bodies, such as sector skills councils—to monitor labor

market trends and workforce characteristics. Taken together, this information helps identify current and emerging skills needs and informs the design and updating of training programs (Levin et al. 2024; Amaral et al. 2017).

Another particularly advanced example is Estonia's Education Information System, a comprehensive administrative database covering all levels of education, from early childhood to higher and vocational education. The system combines data on students, teachers, institutions, and learning outcomes and, crucially, links education records with labor market and population registers. This integration makes it possible to track the employment outcomes of education and training policies and to strengthen evidence-based decision making (OECD 2020).

Portugal also provides an instructive example. ANQEP (Agência Nacional para a Qualificação e o Ensino Profissional [the National Agency for Qualification and Vocational Education]) manages the Qualification Needs Anticipation System (SANQ), which ranks qualifications from one to ten based on labor market priority. SANQ integrates relevant data from multiple sources: ANQEP's analysis of recent employment trends and employer surveys, Cedefop (the European Centre for the Development of Vocational Training), which provides projections of future skills demand, and IEFP (Instituto do Emprego e Formação Profissional [the Institute for Employment and Vocational Training]), which contributes data on regional and occupational job vacancies. SANQ also evaluates training providers using student numbers, certification rates, and graduates' labor market outcomes. Since most data are available at the regional level, SANQ can determine the demand for each qualification in the National Catalogue of Qualifications (OECD 2020).

Strengthen the attractiveness of the TVET teaching profession by creating clear career pathways and targeted incentives for industry professionals, while investing in robust initial pedagogical preparation and continuous professional development. As discussed in Chapter 6, shortages of TVET instructors are widespread and are often driven by salaries that are not competitive and by limited career progression opportunities. To address these challenges, governments can introduce targeted financial incentives, such as bonuses and subsidized initial teacher education, particularly for instructors in high-demand or critical fields. Attracting industry professionals into teaching also requires financial support and incentives to meet teaching qualification requirements, as well as greater flexibility in working arrangements, including part-time modalities (OECD 2021, 2022). In countries where national training institutions rely on instructors who are civil servants, expanding and diversifying the instructor workforce may require broader civil service reforms, undertaken in dialogue with unions.

Equally important are continuous professional development programs that keep TVET instructors' skills up to date and closely aligned with industry practices. Strong incentives are needed to promote partnerships with firms, enabling work-based learning opportunities for instructors and more flexible training delivery that can be combined with teaching responsibilities.

Non-LAC OECD countries provide instructive examples of how these measures can be implemented in practice. In Sweden, grants and reduced teaching hours are offered to TVET instructors who complete initial teacher education while working, lowering barriers for industry professionals to enter the teaching profession. Sweden also ensures that instructors maintain up-to-date pedagogical and technical skills through agreements that guarantee access to continuous professional development. In Spain, Aragón's Centre for Innovation in VET supports teachers by offering training in digital tools, industry-standard equipment, and updated pedagogical approaches. Through close partnerships with industry, the center helps instructors stay aligned with current workplace technologies and employer expectations, strengthening the relevance and quality of TVET provision (OECD 2021).

Strengthen frameworks and institutional capacities to ensure that quality assurance systems in TVET function effectively, explicitly recognizing TVET's core purpose of developing skills for work and embedding employability as a critical outcome.

As discussed in Chapter 6, in many countries in Latin America and the Caribbean, returns to TVET are highly heterogeneous across programs and institutions, which undermines confidence among students, firms, and financiers and makes investment in training inherently risky. Addressing this requires robust quality assurance frameworks that ensure both minimum standards and labor market relevance, often implying updates to existing legal and regulatory arrangements.

A critical first step is the adoption of unified quality criteria across providers. Quality assurance should not vary depending on whether training is delivered by public institutions, private providers, or firms, as is often the case in the region. A second, and equally important, step is to move from an exclusive focus on inputs and procedures toward greater emphasis on results. While overseeing inputs and processes remains essential, particularly in the case of new institutions and programs, mature programs should progressively be assessed on learning outcomes and, crucially, employability outcomes. This also requires quality assurance systems to systematically review and provide feedback on the actions institutions take to strengthen links with the private sector and support graduates' entry into the labor market.

An illustrative example from the OECD is Korea's Skills Quality Authority (KSQA), established in 2015 as a central body for safeguarding the quality of training. Its main objective is to identify and address low-quality programs, particularly those that do not enhance participants' employability. To achieve this, KSQA systematically tracks the labor market outcomes of trainees (OECD 2020).

Advancing in this direction requires time and a series of complementary reforms, including robust systems for tracking employability outcomes. A gradual, bottom-up approach—beginning with the most promising sectors or regions—may be appropriate. Countries can also leverage international accreditation schemes, such as those offered by City & Guilds (UK), to support the development of internal quality standards aligned with international best practices (Levin et al. 2024).

However, these efforts will produce meaningful results only if quality assurance is linked to consequences for failing to meet standards. Tying quality assurance to incentives for improvement is essential. This can include communicating results to the public, awarding quality seals, and publishing outcomes such as learning achievements and employability. Incentives can also be tied to public financing. Several mechanisms for implementing these approaches are outlined in the next recommendation.

Shift public financing of TVET from traditional input-based allocations and payroll-based funding toward results-driven mechanisms and demand-side subsidies that increase accountability and incentivize quality, labor market relevance, and equitable access.

As discussed in Chapter 6, public financing of TVET in the region is highly fragmented, with multiple funding sources often allocated according to historical patterns through earmarked payroll taxes rather than linked to outcomes. In many countries, provision is dominated by national training agencies financed wholly or partially through these earmarked contributions, while demand-side instruments—such as subsidized loans, vouchers, or scholarships—remain limited or nonexistent. Although these arrangements offer predictability and stability for long-term planning, they significantly constrain flexibility, making it difficult to adjust training supply in response to changing skill demands. They also weaken accountability and provide few incentives to improve quality and labor market outcomes.

Addressing these challenges requires a shift toward financing mechanisms that are more closely aligned with demand-driven and results-oriented training. Moving toward results-based financing is therefore critical, and Colombia offers an instructive example of innovation in this area. As discussed in further detail in the next section, the country has introduced

performance-based instruments under which the government compensates private training providers partly for service delivery and partly for achieved employment outcomes, such as the placement and retention of vulnerable job seekers in formal employment (Casas et al. 2025).

Moreover, building on the previous recommendation, public funding should be allocated in ways that incentivize private providers to participate in and comply with quality assurance systems. For instance, national governments implementing publicly funded training programs should contract only with private providers that meet established quality standards. In parallel, demand-side subsidies for TVET—such as subsidized loans, vouchers, or scholarships—should be made available exclusively for programs that both meet quality requirements and respond to demonstrated labor market demand. This approach would not only strengthen incentives for improved outcomes and quality but also help correct an important inequity highlighted in Chapter 6: the concentration of demand-side public subsidies in university education, to the relative exclusion of postsecondary TVET.

Revisions to payroll-based financing also warrant consideration. As noted in Chapter 6, at least 15 countries in the region use payroll contributions—typically from employers, and sometimes employees—to finance training. Payroll taxes provide a predictable source of funds that is not tied to political cycles, enabling long-term investments. However, predictability alone does not guarantee alignment with labor market needs: without accountability for results, such financing can support standardized, low-impact training that is poorly adapted to local conditions, technological change, or industry demand. And, of course, financing through payroll contributions contributes to the nonwage cost of formal salaried employment, which is quite high in the region by international standards.

Several alternatives illustrate ways to mitigate these limitations. Colombia's 2012 tax reform, for example, eliminated mandated payroll contributions to the national training institution (SENA), substituting general-revenue allocations for them while reducing other contributions such as those for health and childcare. This reform had positive effects on formal employment. However, it is important to ensure that such financing arrangements do not become overly dependent on political cycles, thereby affecting the stability and technical independence of training institutions.

Brazil's SENAI provides another instructive example. As the largest institution of professional and technological education in the region, SENAI has historically relied on a stable 1 percent payroll contribution from industrial companies. In the 1990s, the model changed with the introduction of training agreements, under which SENAI implemented or supervised employer-funded training rather than providing it directly through levy-funded centers. This shift encouraged more demand-driven, tailored, and affordable training and reduced

the emphasis on standardized courses financed through the levy. SENAI also invested in information systems, regularly collected output data, conducted perception studies, and tracked graduates in the labor market, providing a strong foundation for results-oriented planning and quality improvement.

Countries that are already developing national qualifications frameworks (NQFs) should prioritize simplicity and cost-effectiveness, avoiding the diversion of limited resources from more impactful reform priorities. NQFs vary widely in scope and ambition, and regional experience shows that they are often costly to design. Moreover, the ongoing effort required to keep them updated and aligned with evolving labor market needs can entail significant and recurring costs. Importantly, the implementation of NQFs does not substitute, and may distract from, more fundamental reforms to improve system effectiveness, such as strengthening teaching quality, implementing results-oriented financing mechanisms, and building systems that systematically collect information on skills needs to inform program design. International experience also indicates that NQFs often face low uptake and limited employer engagement.

Given their high implementation costs and the risk of overstressing TVET administrative capacity, it is essential to keep NQFs simple and to prioritize efforts carefully. This can be achieved by: (i) limiting initial scope and coverage, starting with a small number of priority sectors with large employment shares and where certification adds clear value; (ii) focusing on signaling rather than full system integration, emphasizing clear level descriptors and learning outcomes without immediately linking the NQF to funding, accreditation, or progression across education subsystems; (iii) using and adapting existing occupational standards, certifications, or sectoral frameworks—including those aligned with international frameworks—rather than creating parallel structures; (iv) avoiding overspecification and unnecessary complexity, as rigid qualification structures and burdensome administrative requirements reduce system responsiveness; (v) ensuring that any regulatory functions included in the NQF remain flexible and primarily serve as reference tools, rather than substituting for investments in quality assurance; (vi) setting realistic expectations, recognizing that while features such as learning outcome descriptors can support better alignment with labor market needs, effective alignment ultimately depends on broader investments in governance structures that engage the private sector and in data systems that inform skills demand; and (vii) organizing sectors around value chains that share common occupational functions, so that qualifications do not become excessively specific. For example, it is more efficient and better for labor mobility to define a single qualification for a refrigeration technician than to create separate qualifications for technicians in food refrigeration and technicians in pharmaceutical refrigeration when core functions are essentially the same (Allais 2017; Levin et al. 2024; Grafe and Richard 2022).

Invest in career guidance and mitigate the risks of overspecialization at the expense of foundational skills.

Because of its occupational focus, TVET inherently involves specialization. While this can be valuable, it is also risky and may harm long-term prospects if it comes at the expense of foundational skills, particularly for young people. Moreover, in complex and often confusing education and training systems, inadequate information and guidance can lead individuals to make choices that reduce adaptability and lower returns over the life cycle. For example, as discussed in Chapter 6, evidence from Colombia shows that the expansion of postsecondary TVET without adequate guidance diverted academically well-prepared students into tracks with lower expected returns than university education (Ferreira et al. 2021).

Addressing these risks requires two complementary approaches. First, investing in systematic and accessible career and academic guidance is essential. Guidance services at all key decision points should help individuals compare educational and training options, understand labor market prospects, and make informed choices. This support is particularly important for disadvantaged groups, who face higher risks and have more limited access to labor market information. Guidance systems can be strengthened through transparent information platforms that report employment and earnings outcomes for programs across the TVET system. Chile offers a strong example: as described in Box 8.13, its *Mi Futuro* portal publicly provides data on wages and employability by program and institution for all tertiary programs, including TVET.

Second, the expansion of TVET must not come at the expense of foundational skills, which are critical for employability, adaptability, and long-term career prospects. Ideally, these skills are acquired through general education. When this is not the case, policymakers can delay entry into TVET to allow students to strengthen core competencies, as done in Poland, or they can provide accelerated remedial support through tutoring or bridging programs, as implemented in Australia, Austria, and Switzerland (OECD 2020; Levin et al. 2024).

BOX 8.13

USING DATA TO GUIDE EDUCATION CHOICES: CHILE'S MI FUTURO PORTAL

Chile discloses graduate labor market outcomes through the Ministry of Education's *Mi Futuro* portal, which publishes program-level indicators of employability and earnings for universities, professional institutes, and technical training centers. The data are produced by the Higher Education Information Service (SIES): institutions submit complete rosters of graduates, and SIES links these records to administrative tax data from the Internal Revenue Service to calculate gross monthly income since graduation and to administrative sources used to estimate employment at one or two years after graduation. The portal lets users view statistics for generic fields and compare specific combinations of program and institution, showing income from the first to the fifth year after graduation and employability at the first or second year, alongside contextual information such as enrollment, completions, tuition, and accreditation. The site is updated regularly and is presented as an official decision-support tool for applicants and families, improving transparency and accountability of providers by making outcomes public.

Promote work-based learning (WBL) through clear and enforceable regulatory frameworks, transparent cost-sharing arrangements, and targeted support to firms. WBL is essential for developing job-relevant skills and constitutes a critical stage of TVET. However, LAC faces significant challenges related to the small size of most firms, high informality, limited enforcement capacity, and low awareness among employers. WBL requires time and resources that firms often cannot allocate in the short term, even when the long-term returns are positive. Without adequate institutional support, firms may underinvest in training or misuse apprenticeship arrangements, undermining their developmental purpose. Yet, as discussed in Chapter 6, when well designed and effectively implemented, WBL has a strong positive impact on labor market outcomes, and there are successful international experiences from which to draw lessons. For instance, evidence from a recent impact evaluation shows that apprenticeships in Brazil are more effective than other temporary jobs as stepping stones to permanent employment and higher-quality positions. The evaluation also showed positive effects on reservation wages and educational attainment, strengthening both career prospects and human capital outcomes (Corseuil et al. 2019).

A formal legal framework that clearly defines cost-sharing arrangements is essential. Apprenticeship or training contracts should specify the obligations and responsibilities of employers and learners, learners' rights and protections, the duration and scope of training, legal and administrative conditions, assessment and certification criteria, and any financial arrangements or incentives. Fundamentally, there must be a clear economic rationale. Because apprentices are less productive while acquiring human capital, firms require compensation for their training investment. Ideally, this compensation is embedded in transparent cost-sharing schemes, such as the German model described earlier. Cost-sharing mechanisms not only mobilize resources but also strengthen employer engagement and can be combined with co-design of training programs and support for workplace trainers, ensuring that learning is well supervised and aligned with labor market needs.

Government support can include tax incentives or social security relief to encourage firms to engage in WBL, typically in exchange for a clear and verifiable training plan. However, financial incentives alone are often insufficient. Public support should also include training of trainers to ensure that company staff responsible for supervising apprentices have the capacity to transfer knowledge and develop skills effectively. OECD experience shows that governments can facilitate employer networks to share good practices in apprenticeship training and provide free resources for workplace instructors, including practical guidance and audiovisual materials demonstrating effective training methods (OECD 2022). Formal written agreements should also clearly specify learning plans that ideally lead to industry-recognized certifications.

Strong enforcement is critical to protect learners' rights and welfare. Regulations should limit the number of apprenticeship contracts per firm or per learner to prevent misuse as disguised labor. WBL agreements must be enforceable in practice, with grievance and monitoring mechanisms similar to those of standard labor contracts. In these efforts, TVET institutions can act as key partners, supporting authorities in monitoring quality and enforcing standards.

Caution is also needed in program design to avoid compulsory schemes that generate labor market distortions. Colombia provides a clear example: as discussed in Chapter 6, firms with 20 workers or more are required to hire apprentices or, alternatively, must pay a compensating penalty to SENA, the public training institute, proportional to the minimum wage and firm size. Independent studies show that, in practice, high-productivity firms tend to opt out and pay the levy, while low-productivity firms hire apprentices primarily as low-cost labor. The scheme has also distorted the firm-size distribution. As a result, rather than functioning as a human

capital formation mechanism for young labor market entrants, the apprenticeship contract has operated as a mandatory low-wage hiring scheme with significant labor market distortions (Caicedo, Espinosa, and Seibold 2020; Ospino 2018).

In this context, Colombia has recently promoted an alternative training contract (*modalidad de vinculación formativa*) targeted at smaller firms and startups. This modality allows firms to host students who are actively enrolled in education or training programs and provides coverage against workplace hazards, but does not include wage compensation. If accompanied by adequate enforcement capacity, this approach may offer a promising way to expand WBL opportunities in smaller firms while limiting distortions and misuse.

Finally, technology can help reduce the costs of WBL through virtual environments or blended learning approaches. However, the WBL experience cannot be fully replaced by digital modalities, as it requires direct interaction, hands-on practice, and the development of interpersonal and work-related skills.

Articulate a vision for TVET that moves beyond a remedial or second-tier form of education for those left behind and instead positions it as a central pillar of productive development strategies and adaptation to future economic change. TVET clearly plays an inclusive role, as discussed in Chapter 6, given that it disproportionately serves students from more disadvantaged backgrounds. Its focus on occupation-specific skills also makes it a powerful tool for inclusion, including for students with disabilities that may limit success in general, academic education. However, this inclusive mandate should not obscure the need to reposition TVET as a core component of the productive development agenda.

TVET must be repositioned from a remedial or second-tier educational pathway to a central pillar of productive development and adaptation to future economic change.

This repositioning is important for at least three reasons. First, growth in strategic sectors is often constrained by shortages of relevant human capital, and productive development agendas that rely primarily on top-down instruments—such as tax incentives or wage subsidies—to attract investment are likely to underperform if firms cannot access a workforce with the required skills. Thus, in the absence of effective coordination with TVET systems, skills gaps can become binding constraints that undermine productive development strategies. Second, closer alignment between TVET and productive development agendas strengthens incentives for employer participation and engagement by training providers, creating opportunities

for co-investment and helping channel scarce public and private resources toward sectors with the greatest potential for productivity gains. Third, a productivity-oriented TVET system is better positioned to support the transformations demanded by global structural trends, including technological change, climate change, and demographic transitions.

The region already offers promising examples of this approach. Mexico's aerospace cluster, supported by targeted education and training infrastructure, illustrates how human capital investments can underpin sectoral development and offers a model for similar initiatives elsewhere. As detailed in Box 8.14, Mexico's intervention aligns with a modern approach to productive development policies. Rather than relying on subsidies or tax credits as a one-size-fits-all solution for quality job creation, these strategies emphasize coordination among stakeholders in training, employment, and workforce development (Rodrik 2022).

Finally, it is important to note that aligning TVET with productive development agendas is not limited to traditional sectors such as manufacturing; on the contrary, it is equally—if not more—important in services and commerce. In Latin America and the Caribbean, most workers are employed in these sectors, which still offer significant opportunities for productivity and employment growth. A good example is the care economy, particularly long-term care. Employment in this sector is expected to expand rapidly as populations age and demand for in-home and assisted living arrangements increases. Estimates suggest that the region will need to expand its long-term care workforce from 3 million to approximately 14 million by 2050 (Stampini et al. 2025). While the sector offers opportunities for good-quality jobs, realizing this potential requires a deliberate strategy of specialized training, including certified programs for caregivers, geriatric and dementia care, rehabilitation support, assistive technologies, and the coordination of care services across health and social protection systems.

BOX 8.14

**HOW SKILLS DEVELOPMENT ENABLED THE EMERGENCE OF
QUERÉTARO'S AEROSPACE INDUSTRY**

The origins of Querétaro's aerospace cluster illustrate how a skills development strategy can be integrated into a broader productive development approach. Unlike other strategies that focus primarily on reducing labor costs or offering tax incentives, Querétaro combined these with a deliberate effort to build scientific and technological capabilities alongside industrial development.

The cluster's development began with the arrival of Bombardier as an anchor company. Shortly afterward, in 2007, the Universidad Aeronáutica de Querétaro was founded as a public university, jointly financed by federal and state governments, and remains the only university in Mexico entirely specialized in aerospace. From the outset, private firms and the university collaborated to define the skills and workforce profiles required for the cluster, including the qualifications of teaching staff.

In its early phase, the university's curriculum focused on basic technical skills for simple assembly tasks. By 2009, as the cluster matured, it introduced tertiary-level programs to train technicians in advanced manufacturing skills. From 2010 onward, the university began offering full master's and doctoral programs to support airplane assembly, design, and innovation (Caliari et al. 2025; World Bank 2019).

B) Strengthening Active Labor Market Policies to Promote Inclusion, Employability, and Adaptation

Active labor market policies (ALMPs) consist of interventions designed to support job seekers and typically include job-search assistance, counseling and placement services, training programs, wage subsidies, and public works programs. As discussed in Chapter 3, there are plenty of information frictions in the labor market that limit the possibility of matching workers with the jobs in which they are most productive. ALMPs can play an important role in improving labor market outcomes, supporting workers during transitions, and enhancing productivity by improving the quality of matches. They are also particularly important during periods of job displacement or economic downturns.

As discussed in Chapter 6, impact evaluations of ALMPs in developing countries consistently show that their long-term benefits exceed the costs, highlighting their potential to generate durable economic and social returns. ALMPs are highly flexible, allowing policymakers to tailor interventions to diverse contexts, target populations, and policy objectives. This adaptability

has made them a widely used tool across countries in Latin America and the Caribbean. Moreover, ALMPs are among the most rigorously evaluated labor policies, with decades of research providing robust evidence on what works, for whom, and under which conditions. This body of evidence identifies key design principles that help maximize effectiveness and ensure that public resources are invested efficiently. This evidence from impact evaluations and qualitative studies provides a foundation for the policy recommendations presented below.

Public employment services (PES) require stronger accountability mechanisms regardless of the institutional model adopted. In some countries, such as Colombia and Costa Rica, parts of PES are delivered through private or third-party providers, while, in others, such as Peru, services remain largely public. Across models, governments should invest in transparent reporting systems that track placements, retention after placement, and longer-term labor market trajectories of beneficiaries. Many PES are transitioning from traditional bureaucratic administration to performance-based management, setting targets and establishing internal monitoring systems to evaluate achievement in both processes and outcomes. For instance, in South Korea, an evaluation index weights job placement together with the difficulty of placement, measured by the local employment rate (ILO 2023). Early steps in the region, such as merging PES data with formal labor registries, represent promising progress in this direction.

Moving toward results-based financing is a promising avenue. Introducing results-based financing (RBF) mechanisms in the provision of ALMPs has strong potential, and evidence discussed in Chapter 6 shows that it can increase their effectiveness. In RBF schemes, governments pay service providers or investors partly for service delivery and partly for achieved employment outcomes. This aligns provider incentives with the objective of improving employment results and allows greater flexibility in how services are delivered, supporting individualized interventions. It also helps foster a culture focused on results. In addition, financial risks are reduced because payments are contingent, at least in part, on demonstrated success.

However, RBF mechanisms require careful technical design to avoid unintended consequences such as “creaming,” where providers may concentrate on participants who are easiest to place. Implementation also demands adjustments in budgeting rules and administrative practices to accommodate outcome-based payments. Box 8.15 below highlights important innovations in Colombia that illustrate how these approaches can be adapted to local institutional contexts.

BOX 8.15
**ADVANCING ALMP EFFECTIVENESS THROUGH
RESULTS-BASED FINANCING INNOVATIONS IN COLOMBIA**

Over the past decade, Colombia has pioneered results-based financing (RBF) as a tool to increase the effectiveness of active labor market policies. This process has involved continuous piloting, iteration, and systemic changes for mainstreaming, with participation from national and subnational governments and support from the Swiss Agency for Development and Cooperation (SDC) and the IDB Group. The government mobilized impact investors to prefinance employment services through social impact bonds (SIBs). Investors pay service providers upfront, and the government reimburses investors only when independently verified employment outcomes are achieved. It also implemented performance contracts, where government payments to service providers are partially or fully contingent on employment or retention outcomes, without involving investors. Programs such as *Empleando Futuro*, *Cali Progresas con Empleo*, and Bogotá's performance contracts illustrate how RBF can shift implementation risk away from the state while sharpening incentives for service quality.

However, scaling these financing models revealed important institutional challenges. Annual budget rules and the cash-flow uncertainty associated with paying after outcomes, as well as the strain on contract management and IT systems, all posed barriers as programs moved from pilots to larger operations. Colombia responded with targeted innovations: Fondo LOGRA (outcomes fund) pooled public, private, and international resources and standardized contracts, verification, and payments, which lowered transaction costs and enabled multi-year execution. Bogotá also established a pre-agreement with its finance authority to allow outcome payments across fiscal years. Together, these efforts demonstrate Colombia's commitment to strengthening ALMPs through practical, scalable results-based financing solutions.

Source: Casas et al. 2025.

Digital transformation offers major opportunities to expand the reach and efficiency of ALMPs, but it cannot substitute for well-trained human counselors.

Online job portals, virtual job matching, and digital case management systems can lower costs and improve access, particularly in geographically dispersed regions. Promising experiences in OECD countries show the potential of artificial intelligence in areas such as profiling and segmenting job seekers, improving matches between job seekers and vacancies, providing automated information and counseling via chatbots, and detecting fraud in applications (OECD 2022). Recent experimental evidence shows that algorithmically recommending workers to employers for the purpose of recruitment can substantially increase hiring (Horton 2017). However, evidence shows that trained counselors remain essential to guide job seekers, support employers, and assist vulnerable groups effectively: digital tools should complement, not replace, human intermediation. Investments in PES staff through targeted training are therefore critical. For example, the Slovenian Employment Service conducts dedicated workshops to strengthen employer-facing staff skills in negotiation, relationship building, and practical advocacy techniques to support clients facing complex employment barriers (OECD 2025).

Digital tools should complement, not replace, human intermediation.

PES must work harder to earn employers' trust and serve them effectively. PES in Latin America and the Caribbean have traditionally focused on job seekers, but experience from more mature systems shows that directly engaging employers can generate significant gains. And in fact, even in advanced economies, many PES still struggle with low visibility and trust from employers who often look elsewhere to pay for recruitment (ILO 2023).

Services can support firms by helping formulate vacancy descriptions, identify skill requirements, and broaden outreach to suitable candidates. As discussed in Chapter 6, a randomized evaluation in France's Pôle emploi demonstrates this point: investing in employer support—including proactive employer outreach, in-depth interviews to understand employer needs, marketing of PES services, and assistance with recruitment—led to a 24 percent increase in vacancies posted and substantial increases in hiring of job seekers, including permanent contracts for registered job seekers (Algan, Crépon, and Glover 2020). Building on this, the French public employment service segments employers according to their recruitment potential and identifies major recruiters as well as opinion leaders in the hiring field. This targeted approach allows PES to tailor interventions to the specific needs of firms, increasing the likelihood of effective engagement and fostering longer-term relationships. By contrast, efforts to make vacancy registration compulsory have often failed

to strengthen employer engagement, reinforcing perceptions of PES as bureaucratic and inefficient (ILO 2023). In Colombia, where registration is also mandatory, similar challenges have been observed: mandating firms to advertise job vacancies in the PES portal does not guarantee the quality of information in job listings if firms do not see value in the service. These shortcomings in the quality of data collected by PES limit the effectiveness of employer-focused interventions and underscore the need for better employer engagement.

Expand ALMPs beyond traditional training and job-matching services to reduce information frictions for both workers and employers, improving awareness of outside options and clarity about workers' skills and appropriate wages. As discussed in Chapter 5, evidence shows that workers are often unaware of their outside options, underestimate the potential gains from changing jobs, and hold inaccurate beliefs about their alternatives. For example, a study in Germany found that when workers were provided with information about the wages of similar employees, they corrected their expectations and adjusted their job search strategies and wage negotiation intentions (Jäger et al. 2024). Similarly, in South Africa, supplementing labor market preparation programs with training on online employment platforms increased participants' likelihood of finding employment, largely because access to these tools allowed them to acquire better information about potential employers (Cullen 2024).

Promising evidence also comes from interventions that help workers signal their skills to employers, since as discussed in Chapter 6, workers are often unable to signal their skills. Linking training and assessment outcomes to recognized certifications reduces information asymmetries and improves matching efficiency. In developing countries, efforts to credibly certify existing worker skills have been shown to reduce information frictions, particularly when formal education systems do not provide reliable signals of ability (Carranza and McKenzie 2023). For example, interventions in Ethiopia and South Africa that promoted skills certification of candidates had positive impacts on employability, especially among low-earning individuals with work experience (Abebe et al. 2021; Carranza and McKenzie 2023). This underscores the potential of public certification programs, such as those offered by SENA in Colombia, CONOCER in Mexico, and INFOTEP in the Dominican Republic. Their value, however, hinges on their ability to function as a credible labor market signal: one that employers actively trust and use, supported by rigorous, clearly defined standards endorsed by industry and by strong institutional reputations.

Evidence also highlights the relevance of interventions that help employers set wages. For instance, as discussed in Chapter 6, recent research indicates that many vacancies remain unfilled due to poor wage adjustments by firms (Cullen, Hoffman, and Koenig 2025).

Thus, in general, it is important to underscore the significant role that ALMPs can play in reducing information frictions, through activities that go beyond their traditional focus on training and on merely matching job seekers to vacancies. Job seekers benefit from support in evaluating job opportunities and signaling their skills to potential employers. Employers may need guidance in assessing candidates and even in determining appropriate wages. Moreover, even those already employed can benefit from assistance in deciding whether to seek new opportunities.

Integrate ALMPs with income support programs to enable effective job search and sustainable labor market transitions.

Looking for a job is usually expensive, and unemployed people often have even fewer financial resources to cover such costs, which include, for example, transportation fees to deliver résumés and attend interviews (Asenjo, Escudero, and Liepmann 2024; Nunn 2024; Cavalcanti et al. 2024). Passive labor market policies, such as unemployment insurance or cash transfers, can provide financial support that allows workers to devote time to job search, producing better matches that may lead to more stable and productive work relations (Alaimo et al. 2015). ALMPs build skills and can create a bridge to higher-productivity, formal employment. While active and passive policies are often treated as alternatives, evidence shows that they are most effective when combined, particularly in developing and emerging economies where poor households frequently rely on a mix of cash transfers and informal work, limiting their ability to devote time and resources to job search. Evidence from developing countries illustrates both the potential and the conditions for success of such integration. For instance, a randomized experiment in Sri Lanka combining training with cash transfers for actual and prospective self-employed women found that training alone did not raise productivity, while the combination of training and monetary support led to higher profits, increased sales, and improved management and financial planning practices (de Mel, McKenzie, and Woodruff 2014).

ALMPs should be expanded beyond traditional training and job matching to inform workers about alternative job opportunities and help employers set wages and hire.

Program design plays a critical role in determining whether integrated approaches deliver positive results. Key elements include clear participation conditions and appropriate targeting mechanisms, transfer levels that are sufficient to sustain participation, and active components that are well matched to participants' skills and constraints (e.g., training that builds on prior knowledge). Equally important is adequate institutional capacity to ensure take-up, compliance, and effective coordination across programs (Nunn 2024).

Develop effective and tailored interventions to support vulnerable groups. While a focus on disadvantaged populations has long been part of ALMPs, recent experience points to the value of more holistic and tailored approaches. Long-term unemployed individuals, people with disabilities, youth with weak labor market attachment, and other hard-to-place groups often face constraints that standard ALMPs are not designed to resolve. Effective interventions therefore combine training pathways adapted to these hard-to-place groups with financial incentives for service providers to work with these groups, alongside close monitoring of outcomes (ILO 2023). These approaches also require strong coordination across institutions. For instance, in Europe, public employment services increasingly work closely with pension and insurance funds, health systems, and social services to address constraints that directly affect the employability of people with disabilities (ILO 2023).

Their effectiveness also depends on close and sustained monitoring. In this regard, Estonia provides a concrete example. Since 2021, the Estonian public employment service has introduced systematic follow-up support for groups at high risk of returning to unemployment due to health limitations, limited work experience, or previous long-term unemployment. Case managers continue counseling during the first six months of employment, maintain contact with both the worker and the employer, and involve local social workers or other service providers when needed. This integrated and sustained support has strengthened job retention and improved labor market outcomes for vulnerable participants (OECD 2021).

ALMPs can play an important role in promoting workers' geographic mobility. Productivity losses can be substantial when search and matching frictions slow or prevent the reallocation of workers across sectors and locations, a process that is central to structural transformation. Regional disparities in employment opportunities are large in many countries in Latin America and the Caribbean, and mobility barriers limit adjustment. These constraints not only affect individuals by preventing access to better jobs in other locations but also have aggregate consequences, as they hinder the efficient reallocation of labor across sectors and regions (Carranza and McKenzie 2023). Evidence shows that interventions supporting mobility, such as relocation or transportation subsidies combined with job-search assistance, can improve job prospects, reduce discouragement, align workers' expectations more closely with actual opportunities, and increase access to higher-quality jobs (Franklin 2018; Banerjee and Sequeira 2023).

This evidence supports interventions that subsidize transportation costs for job seekers, particularly when mobility constraints are especially binding, and that combine support with job-search assistance. In this regard, the public employment service in Montenegro implemented an activation program targeting women to increase female labor force

participation, which included coverage of transportation costs. The program recognized that mobility constraints were especially high for women and sought to reduce this barrier to job search and employment (ILO 2023).

Employment subsidies should be carefully targeted, monitored, and time-bound to efficiently expand job access for vulnerable workers, protect employment in recessions, and extend older workers' careers. As discussed in Chapter 6, extensive evidence from both developing and advanced economies shows that employment subsidies can be effective in facilitating labor market entry for vulnerable workers who are far from the labor market, but they frequently suffer from deadweight losses, whereby public resources finance jobs that would have been created in the absence of support. They may also generate displacement effects, as subsidized workers replace unsubsidized ones. In Latin America and the Caribbean, small firm size, high informality, and limited enforcement capacity further heighten the risk that employment subsidies lead to short-lived formalization, followed by a reversion to informal employment once support expires. These risks underscore the importance of clear targeting criteria and a well-articulated rationale for prioritizing specific groups over others.

Considering these risks, the evidence reviewed in Chapter 6 points to several key design and implementation lessons. First, targeting should concentrate on disadvantaged job seekers facing substantial barriers to employment, such as the long-term unemployed or people with disabilities. Second, rigorous monitoring is essential to verify the additionality of subsidized jobs. Third, support should be time-bound and provided at the moment of hiring, which minimizes deadweight losses by operating at the hiring margin, allows firms to assess worker-job fit, and helps unemployed individuals rebuild skills and labor market attachment. Fourth, financial incentives should be integrated with activation measures—such as job-search assistance, counseling, training, and post-subsidy follow-up—to improve job retention.

Employment subsidies can also play an important countercyclical role during crises. They are well suited to respond to downturns because eligibility and generosity can be adjusted in line with labor market conditions. In times of crisis, subsidies that help prevent layoffs and retain workers with critical skills can preserve valuable knowledge within firms. At the same time, these measures support households and businesses by maintaining income and helping them cope with the economic shock.

This role was evident during the pandemic, when many countries, both globally and in Latin America and the Caribbean, used temporary reductions in social security contributions or payroll taxes to ease liquidity constraints and protect jobs. Countries such as Chile, Argentina, Colombia, Peru, Brazil, Barbados, the Dominican Republic, Guatemala, Haiti, Honduras, and

Trinidad and Tobago used these measures to help firms retain workers with key job-specific skills and relationships, reduce layoffs, and support household incomes during the crisis (Pagés et al. 2021; Cejudo et al. 2021).

Some recent studies have evaluated the effects of wage subsidies, highlighting that while they can protect jobs during crises, programs are expensive and experiences are mixed. For example, PAEF (*Programa de Apoyo al Empleo Formal*) in Colombia, a program designed to save jobs during the pandemic by subsidizing up to 50 percent of payroll for firms with fewer than 50 employees, appears to have had a positive and persistent impact on formal employment for both men and women. Cost-benefit analysis shows positive returns. Employment gains were primarily driven by an 8 percent increase in hiring and job creation, alongside an estimated reduction in firm closures. By sustaining firms that would otherwise have exited and boosting hiring among targeted firms, the program preserved formal jobs and stimulated formal employment in Colombia for a considerable period after implementation (Bonilla-Mejía et al. 2025). Similarly, South Africa's Temporary Employer/Employee Relief Scheme (TERS), a wage subsidy supporting workers in firms that partially or fully closed due to the pandemic, appears to have saved at least 2 million jobs. However, the program was costly relative to the wage costs of jobs supported: roughly two-thirds of recipients would likely have retained their jobs without the subsidy. This underscores the trade-off between rapid relief disbursement and precise targeting of workers most in need (Köhler, Bhorat, and Hill 2025). Evidence from Mexico during the 2009 crisis shows that wage subsidies for nine months could be an effective tool to mitigate unemployment. However, the program's impact did not operate through the retention of workers with job-specific skills, as originally intended. Instead, subsidies—which were disbursed primarily toward the end of the program—provided liquidity that allowed firms to hire back workers, sustaining employment through financial support rather than directly preserving existing jobs (Bruhn 2020).

Thus, employment subsidies can be effective tools for protecting jobs in developing countries during large, temporary shocks, operating through multiple channels such as preserving formal employment, stimulating hiring, and sustaining firms that would otherwise have exited. However, careful design is essential to ensure optimal targeting and limited duration to contain fiscal costs and maximize additionality.

Finally, given ongoing demographic change, employment subsidies targeted at older workers merit attention, as they can be an effective tool to delay premature retirement, even if they are less suited for promoting new hires. While evidence from Latin America and the Caribbean remains limited, recent OECD studies suggest that hiring subsidies for older workers can be challenging to implement effectively. Specifically, evidence from Germany shows difficulty in

increasing hires among older workers, with subsidized hires largely replacing unsubsidized ones, whereas studies from Finland and Belgium indicate that subsidies can help delay early retirement by reducing transitions to part-time work or early exit, thereby extending working lives (Boockmann 2015; Brown 2015).

Public works programs can offer short-term employment and income support during economic downturns or in areas with limited private-sector opportunities, but they must include clear exit strategies to avoid trapping participants in temporary, low-productivity jobs. International and regional evidence suggests that public works are most effective when combined with training, certification, and explicit pathways into regular employment, rather than serving as a long-term substitute for labor market integration.

The first step in designing a public employment program is defining its primary goal because the objective determines the duration, targeting, and content of work. Public employment programs can serve multiple objectives and involve trade-offs, including creating jobs, enhancing income security, and providing natural or physical infrastructure, public goods, and services. When the goal is income protection, program design may emphasize benefit adequacy and broad access. While this can provide critical support during economic shocks, it may weaken labor market attachment unless paired with strong activation measures. When the goal is employability, programs can help activate participants, but this typically requires more selective targeting, reaches fewer beneficiaries, and focuses on skill development, which can provide less immediate income security (ILO 2020).

When employability is prioritized, it is important to consider whether other active labor market programs might be more effective in improving labor market outcomes, as discussed in Chapter 6. Wage setting is a critical element of program design. Wages should encourage self-selection, attracting participants who genuinely lack alternative employment while avoiding the displacement of existing private-sector jobs. This typically involves setting program wages below prevailing market wages for low-skilled work but above extreme poverty thresholds, ensuring meaningful support without creating incentives to leave other employment.

If protection is the main goal, integration with other social protection pillars is essential. Public employment programs ideally complement existing social protection schemes by providing job opportunities and income security to those not covered by contributory programs. An example is India's Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), which legally guarantees at least 100 days of wage employment per year to rural households willing to perform unskilled manual work. The program helps alleviate poverty for poor rural households without contributory protection. Evidence from Andhra Pradesh shows

that MGNREGS significantly improves the welfare of participating households, particularly the poor, Scheduled Castes and Tribes, and casual laborers, and it even generates positive spillover effects for nonparticipating households (Liu et al. 2018).

Every public employment program also needs a credible exit path, so participation does not become a dead end. This can include registration with public employment services, recognition of competencies, and targeted training integrated into program workflows. In this regard, South Africa's Expanded Public Works Programme has promising properties. It includes social sector activities with accredited training, supporting transitions into care, early childhood development, and environmental services. This approach increases the likelihood that the public employment program can serve as a bridge from immediate income support to longer-term employability. Moreover, the work undertaken at each site is determined by the community rather than by the government, which can enhance its relevance and impact (ILO 2020; World Bank 2021).

Transparency is a cornerstone of effective public employment programs. In India, MGNREGS combines predictable entitlements with transparent monitoring and community oversight (ILO 2020). Evidence indicates that these mechanisms are generally effective, as fund allocation largely reflects the needs of beneficiaries, although local political factors can sometimes influence distribution (Liu et al. 2018).

Finally, during crises it is crucial that financing mechanisms be responsive to shocks, allowing programs to expand or contract in line with labor market conditions. One approach is to incorporate crisis “top-up” rules into budgets to ensure timely execution. In addition, instruments that are typically activated during downturns should be designed with greater flexibility. While permanent programs require well-defined targeting and eligibility rules, crisis programs must be able to scale up rapidly, prioritize labor-intensive activities, and, when necessary, temporarily relax administrative requirements. In these contexts, a larger share of resources may need to be directed toward income support, with programs scaling back as recovery takes hold (ILO 2022).

Moreover, governments should leverage and adapt existing public employment programs to respond to shocks, rather than creating new instruments from scratch. Long-standing programs can be rapidly scaled up and temporarily reoriented to provide immediate income support and employment during crises. For example, *Trabaja Perú*—a long-running public employment program—has been effectively used to deliver timely assistance during natural disasters and other emergencies (Baptista et al. 2024).

ALMPs should be positioned to equip workers with skills aligned with future labor market demand and to support transitions arising from technological change, energy transition, and demographic shifts. This is critical because ALMPs play a central role not only in supporting individual workers but also in facilitating economy-wide adjustment. Structural changes that result from technological change, demographic transition, or energy transition policies will inevitably lead to job losses in some sectors, create opportunities in others, and generate broader social costs. Ensuring that institutions are prepared to deliver targeted training, career counseling, and placement services is therefore essential to help workers navigate these transitions and to minimize disruption to communities and the economy.

Attention should be paid to communities or regions that are disproportionately affected by structural change. Place-based strategies are especially important in locations highly exposed to transition risks, such as coal-producing regions. In these contexts, agreements with local authorities should link ALMP funding to clearly defined measures, outcomes, and timelines. Moreover, investments in robust information systems capable of anticipating how skills demand will evolve are essential.

In Flanders (Belgium), for example, a strategy currently under development sets out how the region will equip its workforce with the skills needed for the green transition in sectors such as construction, energy, manufacturing, and the circular economy. The strategy includes a clear roadmap with concrete actions and a comprehensive communication plan and is built around (i) formal agreements between public and private stakeholders to collaborate on anticipating future skills needs; (ii) co-funding instruments that enable public–private co-investment in training for the green transition; and (iii) accelerated calls for action that provide targeted funding to respond rapidly to urgent skills shortages (OECD 2025).

Effective transition strategies should combine ALMPs that support reemployment in emerging sectors with adequate income support for displaced workers. Training and job-search assistance can facilitate adjustment toward more sustainable livelihoods, but income support is also needed to protect households whose earnings depend on environmentally harmful activities. One example is Brazil's Seguro Defeso – Pescador Artesanal, which provides unemployment insurance to artisanal fishers during the annual fishing ban in the Paraguay River basin (Baptista et al. 2024). Such interventions are valuable as a source of income protection, although it is important to acknowledge that broader structural reforms—such as those discussed in Section 8.2.1.C, which aim to delink access to social protection from the nature of employment—would more systematically extend health and pension coverage to workers displaced by structural change.

Avoid the proliferation of narrowly targeted ALMPs introduced primarily for political reasons and without an evidence base.

While ALMPs are politically attractive and can deliver visible outputs (e.g., the number of participants trained), their effectiveness depends critically on sound design and rigorous evaluation. Although ALMPs are among the most extensively evaluated social policies, the evidence shows that many well-intentioned programs fail to deliver meaningful impacts. A strong commitment to evidence is therefore essential, as is avoiding the use of ALMPs as substitutes for deeper structural reforms that could benefit generations of workers.

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9

**Transformational Progress
Can Be Achieved One Step
at a Time**



We Aspire to Substantially Improve Productivity and Labor Outcomes

In Chapter 8, we outlined both overarching principles for labor policy and concrete recommendations aimed at simultaneously improving labor productivity, increasing the share of total surplus accruing to workers, and reducing inequality in the labor market. What would happen if these principles were fully applied?

Labor regulation would retain its fundamental purpose of improving working conditions by strengthening workers' bargaining power. With proper design and calibration, labor regulation would avoid the common trap of reducing productivity and, in many cases, would actively contribute to productivity gains. This would imply, for example, that minimum wages would be set at levels aligned with economic realities and would not be used as a numeraire for unrelated objectives. Different types of work, including new forms enabled by recent technological advances, would be regulated with neutrality, neither promoted nor discouraged, allowing productivity and worker preferences rather than policies to determine which forms of work become more prevalent over time.

Stronger collective bargaining would be promoted through reforms that could modernize organized labor while restoring accountability and trust. Laws designed to protect workers from arbitrary or unfair practices would not remain merely aspirational but would be effectively enforced. Policymakers would devote at least as much effort to building implementation and enforcement capacity as to designing regulations.

Workers would also be protected against a range of shocks in ways that would not penalize formal and productive employment. Access to, and the financing of, universal protections such as health care would not be contingent on contractual labor relations, thereby lowering the nonwage costs of formal salaried employment and expanding coverage across different forms of work. Other protections, such as old-age pensions, would no longer be tied to a specific job or sequence of jobs, but rather to the individual. Pension contributions and entitlements would be calculated as a function of total income from all sources, eliminating many of the complexities that plague contributory pension systems today. Only protections covering risks directly associated with a job would be financed through mandatory employer-employee contributions. Jobs with higher risks of unemployment or workplace accidents would face higher contribution rates to insure workers against those risks.

Technical and vocational education and training (TVET) would no longer be treated as an afterthought or a second-tier alternative, but as a central investment in human capital capable of delivering substantial productivity gains. A coherent strategic vision would bring together multiple stakeholders to ensure that individuals could acquire the skills needed in

an ever-evolving labor market while ensuring quality and alignment with employers' needs. This would require financing mechanisms that incentivize results, stronger private sector engagement, and sustained investment in training systems.

Active labor market policies would not serve merely as palliatives for workers at the margins, but as core instruments to develop skills and improve labor market matching, based on the principle that—with the right support—everyone could engage in productive work. Both firms and workers would have access to the information needed to make labor markets more efficient. Workers would receive assistance not only in finding jobs but also in evaluating alternatives and credibly signaling their skills to employers. Firms would be supported in identifying suitable workers and setting appropriate wages for vacancies. Even employed workers would have access to information about potentially more attractive job opportunities.

None of this is easy to accomplish, but there is momentum to build upon. As Chapter 8 showed, several countries in the region have already taken meaningful steps in this direction, even when reforms have entailed political costs. Moreover, global and regional experience has demonstrated that significant progress can be achieved without grand political bargains. Technological advances have also lowered the cost of implementation-oriented reforms, and proven practices are being adapted and replicated.

Across the region, there are efforts to reduce reliance on payroll taxes for insuring non-labor-related risks, such as health, childcare, and training. There are also innovations that unify digital platforms, enabling independent workers to pay taxes and social contributions through a single window. Orderly minimum wage reforms have been implemented through deindexation and technical adjustment mechanisms, while collective bargaining institutions have been strengthened by modernizing unions and expanding women's representation. Unemployment insurance systems have been improved by linking income support to rapid job-search assistance. Social security registration for vulnerable workers has been made easier. Additional initiatives have reduced congestion in labor courts and enhanced enforcement through specialized agencies. Workers have gained access to information on their social security payments, giving them greater control over their benefits. Work-based learning has been promoted through apprenticeship contracts, results-based financing has been introduced for active labor market programs, and TVET has been placed at the center of productive development strategies in high-productivity sectors, driving both skills development and economic growth.

These efforts are critical and show that progress is possible, but to date they have been the exception rather than the norm. While labor institutions are not the sole determinant of long-run growth and prosperity, they are unquestionably central. With large shares of unprotected and disenfranchised workers, widespread noncompliance, persistent distortions, and chronic underinvestment in skills over the life cycle, the region has little prospect of realizing its growth potential and reducing poverty and inequality. These challenges will likely be intensified by demographic shifts and rapid technological change. Put simply, without stronger labor policies, Latin America and the Caribbean will not be more productive, and workers' welfare will not improve.

Stronger labor policies in Latin America and the Caribbean are necessary to spur productivity growth and improvements in workers' welfare.

Achieving the Goals of This Book Is Possible

A central message of this final chapter is that following the path outlined in the book is feasible: policymakers can set the region on a course of increased productivity growth that translates into improved working conditions and strengthened social protection. There are practical ways to move forward in a gradual yet purposeful manner that will, over time, lead to transformational progress.

We Can Move Forward Gradually Despite the Fiscal Costs

One obvious objection to some of our recommendations is that it is naive to ignore their fiscal costs. One example is the elimination of employer-employee payroll contributions that finance health care for formal workers and their beneficiaries. The fiscal cost of this measure, if implemented fully, is likely to be approximately 1.1 percent of GDP (IDB 2021), although it varies by country. What can policymakers do if that fiscal cost is impossible to take on in the short term?

There are at least two options, which can be combined in a single reform. The first is to specify in a health reform a clear, gradual phaseout of the payroll contribution—potentially over a period such as ten years—which avoids the need for an abrupt increase in tax revenues. The second option is to implement the measure partially, that is, to reduce but not completely eliminate the contribution. In this way, the reform clearly advances toward the long-term goal while recognizing the short-term fiscal constraint. One interesting way to

reduce but not eliminate the payroll contribution would be to exempt income up to a certain threshold from these contributions, while maintaining the same marginal rate for income above the threshold. This would also strengthen the progressivity of the system, disproportionately lowering the costs of formality for low-income workers, who are the most difficult to formalize.

Fiscal constraints may justify a more gradual pace of reform, but they do not justify inaction.

Thus, the fiscal cost of moving toward the long-term goal of eliminating the payroll contribution for health care can be as small as necessary to accommodate the available fiscal space. While a modest reform on its own may be insufficient to generate significant gains in productivity and equity, it would still constitute a step in the right direction. Progress may be gradual and could take decades, but small increments are better than inaction and much better than policy reversals.

Health care reform is not the only relevant example. In other contexts, pension reform may be at the center of the policy debate, or opportunities may arise to reform a poverty or family allowance program that is largely financed with payroll contributions corresponding to salaried workers. In any case, the general recommendation of delinking some elements of social protection from the job, which leads to a reduction in the cost of formality, can be implemented gradually, partially, or both. We recognize the fiscal constraints that countries in the region face and that progress may be gradual. Nonetheless, policymakers should continue to advance this agenda, as meaningful steps can fit any budget. Similarly, underfunded skills training institutions and public employment services could be assigned more resources through gradual steps, with increases as small or large as fiscal space allows.

Importantly, these efforts can be combined with recommendations outlined in the book that can generate significant savings. In the case of pensions, for example, adopting an actuarially fair contributory pillar can generate significant fiscal savings in the long run.

For all of these reasons, policymakers can advance toward the objectives of this book at a reasonable fiscal cost—with "reasonable" defined as close to zero as the policymaker desires. Progress is therefore feasible, even under tight constraints. While high fiscal costs may justify a more gradual pace of reform, they do not justify inaction. If improving productivity and workers' welfare is a priority, it follows that some effort will be made to create fiscal space to move forward. As James W. Frick put it, "Don't tell me where your priorities are. Show me where you spend your money and I'll tell you what they are."

We Can Move Forward Gradually on Politically Sensitive Topics

Another concern regarding many of the recommendations is that it may be difficult to achieve the political consensus necessary to move forward. The book addresses controversial topics such as minimum wage adjustment and union strengthening, which often lead to protests and political strife. These issues are not easy to address, but policymakers in the region can still make meaningful progress.

As with reforms that entail significant fiscal costs, policies that carry significant political costs can be addressed gradually. It is not necessary, for example, to reform the entire labor code at once. There is ample room for improvement in labor codes over many rounds of reforms.

More importantly, one of the key strengths of this book is that its policy recommendations transcend ideological divides. As discussed in Chapter 1, it pushes past the false dichotomy of a “pro-business” versus “pro-worker” reform. Measures that strengthen enforcement and improve compliance by firms—often labeled “pro-worker”—can be paired with reforms that reduce compliance costs for firms, often labeled “pro-business” (see, for instance, Box 8.2 on the Mexican outsourcing reform). Similarly, policies that correct excessively high minimum wages can be combined with measures that strengthen collective bargaining rights, and the expansion of unemployment insurance can be accompanied by adjustments that reduce severance costs. The quotation marks around the terms “pro-business” and “pro-worker” are, in fact, intentional, as these labels mischaracterize the policies, which are better understood as responses to specific failures in the labor market.

This book aims to help policymakers create an environment that is more conducive to consensus formation. A reform process in which the initial goal is to lower costs for firms will naturally face resistance from workers, who will suspect that lower firm costs will translate into lower wages or benefits. A reform process with an initial goal of raising wages with no mention of productivity will naturally face resistance from firms, which will expect to receive a lower share of a pie that does not grow and may even shrink. On the other hand, a reform process that recognizes the importance of strengthening workers' bargaining power but seeks to redesign policy instruments to achieve better outcomes for firms and workers will be more difficult to oppose. Likewise, a reform process that

The most promising reforms are not simply “pro-business” or “pro-worker”; they are designed to correct market failures while improving outcomes for firms and workers alike.

recognizes the importance of protecting people against numerous shocks, including job loss, illness, on-the-job accidents, and outliving their retirement savings, but also seeks to provide this protection in a way that is most conducive to the creation of good jobs, is more likely to command broad public support.

Controversial reforms are neither costless nor easy. However, the way reforms are framed can significantly affect their feasibility and the space for building agreement. Defining from the outset objectives that are not inherently divisive can help reduce unnecessary polarization and make progress more attainable over time. As James W. Frick noted in relation to fiscal costs, a useful way to discern a government's priorities is by how it allocates its political capital. In that sense, it would be desirable for at least part of that political capital to be directed toward improving productivity and labor market outcomes.

We Can Move Forward Gradually, but We Need to Move Forward

We note in Chapter 2 that many of the problems we document and the solutions we propose are not new. We cited a book published more than twenty years ago (Cowan et al. 2004), which shares several of the policy recommendations we present in this book. We have learned a great deal in the last two decades—both the diagnosis of the problems and the details of the proposed solutions have improved substantially—but the region would be in a substantially better position today if more of the recommendations from the 2004 book had been implemented.

Chapter 2 also documents improvements in several dimensions of the labor market, including labor utilization, earnings, and formality. Taken together, however, these gains have been modest, and progress has slowed or even stalled over the past decade. Moreover, rather than converging with advanced economies, the region is generally falling farther behind. This lack of meaningful progress should be cause for alarm and a catalyst for substantial policy change.

We should also be clear about how and why improvements in labor outcomes have been achieved. A commodities boom in the early part of the twenty-first century helped considerably, but we should not assume that good fortune in the form of positive external shocks will continue to favor the region. We have benefited from favorable demographic tailwinds, with the working-age population steadily increasing as a percentage of the total population, but that demographic boom is coming to an end. We will need good policies to replace the good fortune and favorable demographic trends that have helped us in recent decades.

Persistently low productivity underlies the modest improvements observed in labor market outcomes, which are closely linked to a labor market structure dominated by small, low-productivity firms. Self-employment and very small firms account for an unusually large share of employment by global standards, and this composition has changed little over time. There are also large inequities in labor market outcomes, with women, people with lower levels of education, and people with disabilities, among other groups, facing particularly severe labor market challenges. Inequality is further exacerbated by weak competition in the labor market, which allows employers to pay workers substantially less than the value of what they produce. Human capital problems also explain many of the productivity and inequality challenges the region continues to face.

For these reasons, comprehensive reform is needed. Such reform means structural change, which, as illustrated by only the sparse examples included in Chapter 8, has been extremely uncommon to date. Political, fiscal, and technical challenges are clear and evident, but they must be addressed: meaningful structural reform is essential to improving labor market outcomes in the region. A comprehensive agenda must also include stronger implementation of existing policies, supported by greater capacity across the institutions that shape labor markets.

Our hope is simple: that twenty years from now, labor policy in the region will be seen to have advanced significantly, and at a clearly faster pace than that achieved up to 2026, when this book was completed. That is the reason this book was written and the standard against which it should be judged.

A detailed illustration of a construction worker in a white t-shirt, blue jeans, and black rubber boots. He is wearing a black cap with safety glasses perched on his forehead. He is bent over, using a trowel to smooth a pile of wet concrete on a construction site. The background is a solid blue color.

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Appendix



Appendix

Appendix 1 – Data Sources

The Information System on Labor Markets and Social Security (SIMS) encompasses harmonized statistics for 25 countries in the region, ensuring the comparability of indicators across countries and over time. In this book, trend analyses are based on data from 17 Latin American and Caribbean (LAC) countries with available data for 1995–2024. For countries or variables with missing years, we use linear interpolation. This ensures that the gaps do not distort the overall patterns observed in the dataset. This approach allows for a more continuous and comprehensive analysis of labor market dynamics in the region.

	ARG	BOL	BRA	CHL	COL	CRI	DOM	ECU	GTM	HND	MEX	PAN	PER	PRY	SLV	URY	VEN
1995	●	●	●		●	●	●	●		●		●		●	●	●	●
1996	●	●	●	●	●	●	●	●		●	●	●		●	●	●	●
1997	●	●			●	●	●	●		●		●	●		●	●	●
1998	●		●	●	●	●		●		●		●	●	●	●	●	●
1999	●	●			●	●		●		●		●	●	●	●	●	●
2000	●	●		●	●	●	●	●	●		●	●	●		●	●	●
2001	●	●	●		●	●	●	●		●		●	●		●	●	●
2002	●	●	●		●	●	●	●	●	●	●	●	●	●	●	●	●
2003	●	●	●	●	●	●	●	●	●	●		●	●	●	●	●	●
2004	●		●		●	●	●	●	●	●	●	●	●	●	●	●	●
2005	●	●	●		●	●	●	●		●	●	●	●	●	●	●	●
2006	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
2007	●	●	●		●	●	●	●	●	●	●	●	●	●	●	●	●
2008	●	●	●		●	●	●	●		●		●	●	●	●	●	●
2009	●	●	●	●	●	●	●	●		●	●	●	●	●	●	●	●
2010	●				●	●	●	●	●	●	●	●	●	●	●	●	●
2011	●	●	●	●	●	●	●	●	●	●		●	●	●	●	●	●
2012	●	●	●		●	●	●	●	●	●	●	●	●	●	●	●	●
2013	●	●	●	●	●	●	●	●	●	●		●	●	●	●	●	●
2014	●	●	●		●	●	●	●	●	●	●	●	●	●	●	●	●
2015	●	●	●	●	●	●	●	●	●	●		●	●	●	●	●	●
2016	●	●	●		●	●	●	●	●	●	●	●	●	●	●	●	●
2017	●	●	●	●	●	●	●	●	●	●		●	●	●	●	●	●
2018	●	●	●		●	●	●	●	●	●	●	●	●	●	●	●	●
2019	●	●	●		●	●	●	●	●	●		●	●	●	●	●	●
2020	●	●	●	●	●	●	●	●			●		●	●	●	●	●
2021	●	●	●		●	●	●	●	●				●	●	●	●	●
2022	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
2023	●	●	●		●	●	●	●		●		●	●	●	●	●	●
2024	●		●		●	●	●	●	●	●	●	●	●	●		●	

Appendix

Further notes:

- Regarding the disaggregations used, all definitions are consistent with the methodology developed by the IDB⁶¹ for the construction of homogeneous indicators for all LAC countries.
- Finally, for figures that compare specific years in countries where no survey is available for one of those three years, the series was completed using the closest available year.

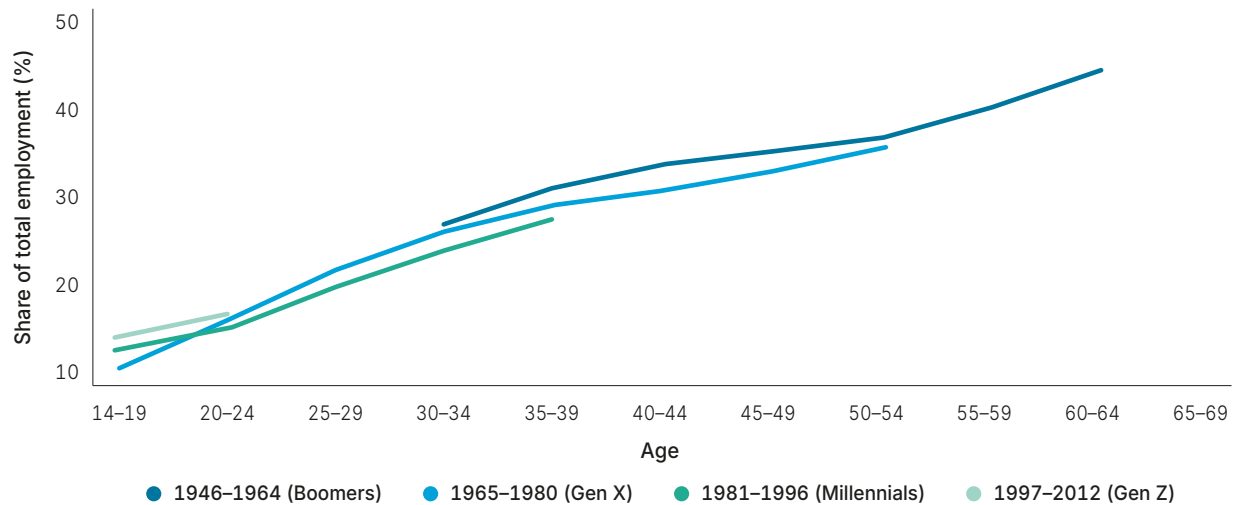
This book clearly reflects gaps in data and research on the labor market in the Caribbean, primarily because such data are absent or inaccessible. While Latin American countries regularly produce data and make them publicly accessible, the situation in the Caribbean is very different. Some Caribbean countries conduct household or employment surveys only sporadically. Others produce data, but these are neither public nor readily accessible to researchers. A substantial share of the data used in this book is longitudinal and either does not exist for any Caribbean country or is otherwise inaccessible.

61. See: <https://knowledge.iadb.org/en/open-knowledge/code-development/open-source-solution/methodology-handbook-data-and-indicators-latin-america-and-caribbean>.

Appendix

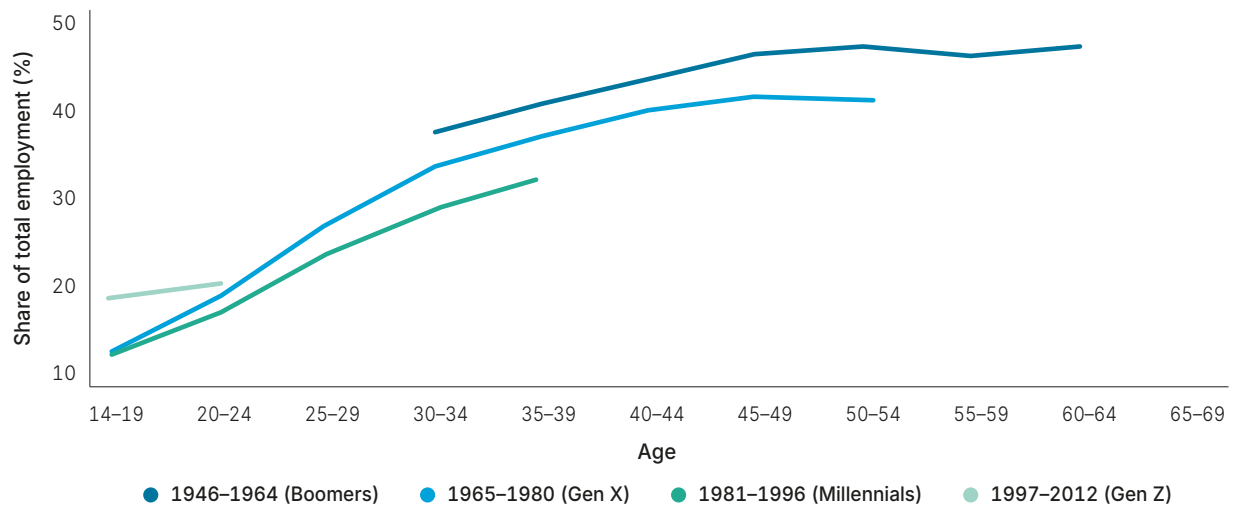
Appendix 2 – Differences in Type of Work among Generations

FIGURE A.1 SHARE OF INDEPENDENT WORKERS ACROSS DIFFERENT COHORTS (%) – LAC-16



Source: Authors' elaboration.

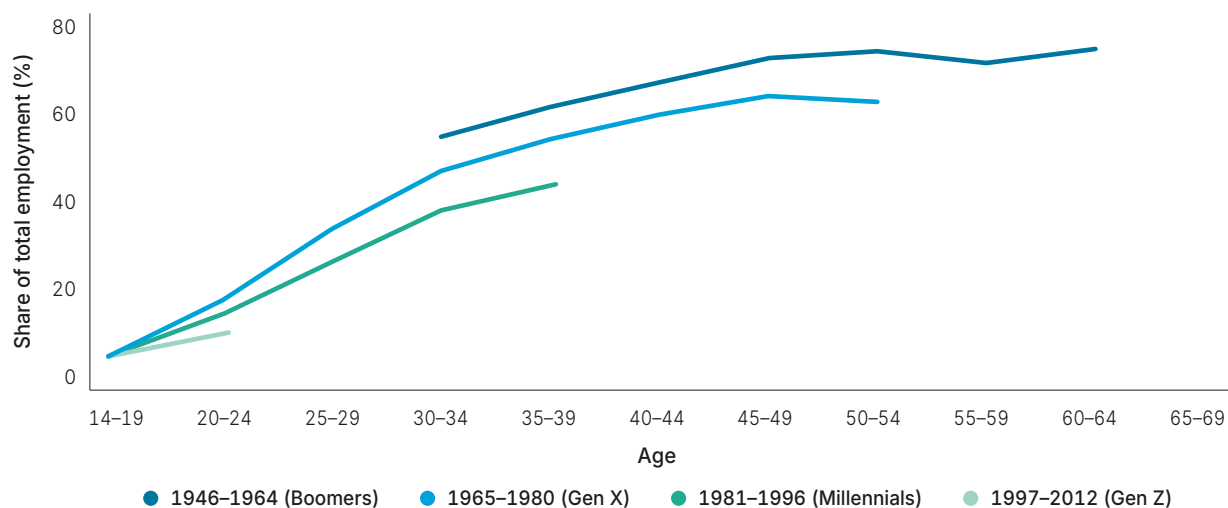
FIGURE A.2 SHARE OF EMPLOYERS ACROSS DIFFERENT COHORTS (%) – LAC-16



Source: Authors' elaboration.

Appendix

FIGURE A.3 SHARE OF SELF-EMPLOYED WORKERS ACROSS DIFFERENT COHORTS (%) – LAC-16



Source: Authors' elaboration.

Appendix

Appendix 3 – Formality Shift-Share Analysis

We decompose the overall change in formality into two components: the composition effect and the shift effect. The composition effect reflects how changes in the share of wage workers (w) versus independent workers (i) influence the overall formality rate (F), while the shift effect captures changes in formality rates within each group. The analysis is illustrated in the equation below:

$$\Delta F = (F_t - F_{t-1}) = \underbrace{s_{w,t-1}(f_{w,t} - f_{w,t-1}) + s_{i,t-1}(f_{i,t} - f_{i,t-1})}_{\text{Shift Effect}} + \underbrace{f_{w,t-1}(s_{w,t} - s_{w,t-1}) + f_{i,t-1}(s_{i,t} - s_{i,t-1})}_{\text{Composition Effect}}$$

Where:

- F_t is the overall formality rate at time t ;
- $s_{w,t}$ and $s_{i,t}$ are the shares of wage and independent workers at time t ; and
- $f_{w,t}$ and $f_{i,t}$ are the formality rates for wage and independent workers at time t .

To perform the shift-share analysis, we compare formality rates between two time periods for each worker group, calculate the change for each group, and weight these changes by their baseline employment shares. This process isolates the contributions of shifts within groups—the shift effect—and changes in group composition—the composition effect—to the overall change in formality.

Appendix

Appendix 4 – Protection against Dismissal Regulation

COUNTRY	PREGNANT WOMEN AND/OR WOMEN ON MATERNITY LEAVE	WORKERS WITH FAMILY RESPONSIBILITIES	WORKERS' REPRESENTATIVES	CONFIRMED INJURED WORKERS	OLDER WORKERS	WORKERS WITH DISABILITIES	WORKERS PERFORMING MILITARY/ALTERNATIVE SERVICE	TEMPORARY LEAVE FOLLOWING AN OCCUPATIONAL DISEASE OR A WORK INJURY	DISCHARGING A PUBLIC FUNCTION	WAR VETERANS	NATIONALS	LONG PERIOD OF SERVICE	MINORS
Antigua and Barbuda	×	×	✓	×	×		×	×		×	×		×
Argentina	✓	✓	✓	×	×		✓	✓	✓	✓	✓	✓	×
Bolivia	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Brazil	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Chile	✓	✓	✓	✓	✓	✓	✓	✓	✓	×	×		×
Colombia	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Costa Rica	✓	✓	✓	×	×		✓	✓		×	×		×
Ecuador	✓	✓	✓	×	×		✓	✓	✓	×	×		×
El Salvador	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Guatemala	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Honduras	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Mexico	×	×		×	×		×	×		×	×		×
Panama	✓	✓	✓	×	×		✓	✓	✓	×	×		×
Paraguay	✓	✓	✓	×	×		✓	✓	✓	×	×		✓
Peru	✓	✓	✓	×	×		×	✓		×	×		×
Saint Lucia	✓	✓	✓	✓	✓	✓	×	✓		×	×		×
Uruguay	✓	✓	✓	×	×		×	✓		✓	✓	✓	×
Venezuela	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	×
LAC Average	90%	90%	90%	15%	15%	15%	70%	70%	70%	20%	20%	20%	10%
Africa	89%	89%	89%	0%	0%	0%	75%	75%	75%	7%	7%	7%	0%
Arab States	80%	80%	80%	0%	0%	0%	20%	20%	20%	0%	0%	0%	0%
Asia	78%	78%	78%	17%	17%	17%	44%	44%	44%	11%	11%	11%	6%
Europe	90%	90%	88%	68%	68%	65%	83%	83%	83%	13%	13%	13%	8%

Source: ILO EPLex Database.

Note: Data are from 2019 or the latest available year. A check mark (✓) indicates that the country's legislation provides special protection against dismissal for that category of workers; a cross (×) indicates that it does not; a blank cell indicates that no information is available.

Appendix

Appendix 5 – Weeks of Severance Pay and Notice Period in LAC, 2004–2020

COUNTRY	AVERAGE SEVERANCE PAY FOR REDUNDANCY DISMISSAL			AVERAGE NOTICE PERIOD FOR REDUNDANCY DISMISSAL		
	2004	2012	2020	2004	2012	2020
Ecuador	32	32	32	-	-	-
Guatemala	27	27	27	-	-	-
El Salvador	23	23	23	-	-	-
Dominican Republic	22	22	22	4	4	4
Argentina	23	23	23	7	7	7
Mexico ⁽¹⁾	22	22	22	-	-	-
Panama ⁽²⁾	18	18	18	-	-	-
Chile	23	23	23	4	4	4
Brazil	9	9	9	4	4	7
Colombia	17	17	17	-	-	-
Uruguay	21	21	21	-	-	-
Jamaica	10	10	10	4	4	4
Costa Rica	14	14	14	4	4	4
Peru	11	11	11	-	-	-
Bahamas	11	11	11	2	2	2
Belize	5	8	8	3	5	5
Barbados	13	13	13	-	-	4
Trinidad and Tobago	14	14	14	6	6	6

Source: World Bank, Employing Workers Project.

Note: The average notice period was calculated as the average for workers with 1, 5, and 10 years of tenure. (1) In Mexico, dismissals are justified only if, in the course of employment, the worker is guilty of a dishonest or dishonorable act, has a physical or mental disability, or demonstrates manifest unfitness for the position. (2) Under Panama's Labor Code, employers must deposit 1.92% of the employee's monthly salary into an individual severance fund held in the worker's name at a local financial institution.

Appendix

Appendix 6 – Literature Review on the Impact of Lower Labor Costs and Labor Market Outcomes, OECD

COUNTRY	REFORM CONTEXT	EFFECT ON FORMAL EMPLOYMENT	EFFECT ON WAGES
Hungary: 2013 (Bíró et al. 2022)	Reduction in payroll taxes equivalent to 6.3% of the average wage.	1.59% (all firms); 3.18% (low-productivity firms); -0.03% (high-productivity firms)	0.221% (all firms); -0.077% (low-productivity firms); 0.602% (high-productivity firms)
Spain: 2009 (Campoy-Muñoz et al. 2016)	Reduction in employer social security contributions, compared across three scenarios: no compensation, compensation through indirect taxes, and compensation through personal income tax.	-1.532% (no-compensation scenario); 0.000% (indirect tax compensation); -1.683% (personal income tax compensation)	N.A. (refers to the unemployment rate)
Belgium: 1997–1999 (Goos and Konings 2007)	Reduction in payroll taxes for manual workers under the Maribel Program.	5.7% (all years); 7.9% (1997 Maribel Program); 5.4% (1998 Maribel Program); 4.9% (1999 Maribel Program)	1.7% (all years); 1.0% (1997 Maribel Program); 2.8% (1998 Maribel Program); 1.6% (1999 Maribel Program)
Italy: 2013 (Rubolino 2022)	50% payroll tax reduction for hiring women.	4.4% (refers to female employment growth in eligible municipalities)	-7.1% (gross wages); 1.2% (net wages)
Norway: 2004–2006 (Ku, Schönberg, and Schreiner 2020)	Increase in payroll tax rates in areas with previously reduced rates.	-1.37%	-0.32%
Norway: 2000 (Stokke 2021)	Reform of the 4.2% payroll tax rate, differentiated by region.	5.2% (not significant at the 95% confidence level)	1%
Canada: 2007–2008 (Deslauriers et al. 2021)	Reduction in the payroll tax rate for medium-sized firms in Manitoba.	-1.50%	4.20%
Turkey: 2010 (Betcherman, Daysal, and Pagés 2010)	Subsidies targeted only at newly registered workers, with additional incentives, including income tax credits and energy subsidies.	5% (in provinces affected by the 2004 law, without province-specific trends); 8% (in provinces affected by the 2004 law, with province-specific trends); 10.8% (in provinces affected by the 2005 law, without province-specific trends); 14.2% (in provinces affected by the 2005 law, with province-specific trends)	0.2% (in provinces affected by the 2004 law, without province-specific trends); -0.7% (in provinces affected by the 2004 law, with province-specific trends); -3.1% (in provinces affected by the 2005 law, without province-specific trends); -2.7% (in provinces affected by the 2005 law, with province-specific trends)
Sweden: 2007 (Egebark and Kaunitz 2013)	11% reduction in payroll taxes for young workers.	2.7% (in 2007); 1.4% (in 2008)	1.2% (in 2007); 1.3% (in 2008)

Source: Authors' elaboration.

Appendix

Appendix 7 – Protection of Regular Workers against Individual Dismissal (EPR Index), 2013–2023

COUNTRY	2013	2023
Guatemala	1.4	1.4
Peru	1.6	1.6
Jamaica	1.6	1.6
Colombia	1.7	1.7
Costa Rica	1.7	1.7
El Salvador	1.7	1.7
Brazil	1.8	1.9
Paraguay	1.9	1.9
Mexico	1.9	1.9
Uruguay	1.9	1.9
Dominican Republic	2.0	2.0
LAC	2.0	2.0
Honduras	2.1	2.1
Ecuador	2.1	2.1
Bahamas	2.1	2.1
Argentina	2.1	2.1
Panama	2.4	2.4
Chile	2.5	2.5
Bolivia	2.7	2.7
Venezuela	3.5	3.5

Source: Alaimo, Altamirano, and Minaya (2026).

Note: The index takes values from 0 to 6, where 0 represents the least strict level of protection, indicating greater flexibility for employers to hire and dismiss workers, and 6 represents the strictest level, indicating stronger employee protection and making it more difficult and costly for employers to dismiss workers.

Appendix

Appendix 8 – PIAAC Skills Mismatch Methodology

Our skills mismatch analysis draws on data from the Organisation for Economic Co-operation and Development's (OECD) Programme for the International Assessment of Adult Competencies (PIAAC), covering 28 countries, four of which are in Latin America and the Caribbean (LAC). We follow the methodology proposed by Bandiera et al. (2024), which characterizes the distribution of employed workers according to the quality of the match between their skills and the requirements of their occupation. The analysis has four main steps: constructing task-based skill requirement indices for occupations, measuring worker skills from PIAAC assessments, assigning both workers and occupations to global quintiles, and classifying the resulting worker-occupation pairs into match quality categories.

Step 1 — Constructing Task-Based Indices of Job Skill Requirements

Rather than relying on externally defined benchmarks, such as peer-based means or professional job analyst ratings, Bandiera et al. (2024) construct occupation-level skill requirement indices from workers' self-reported task use on the job. For each employed worker, the PIAAC background questionnaire records the frequency with which they perform a set of tasks at work. We select tasks across the dimensions of literacy and numeracy. For each task, we assign a difficulty weight that reflects its cognitive complexity. The weights are summarized in the tables below.

Literacy Tasks (12 Items):

TASK	WEIGHT
Read directions or instructions	1.0
Read letters, memos, or emails	2.0
Read newspapers or magazines	2.0
Read professional journals or publications	4.0
Read books	4.0
Read manuals or reference materials	3.0
Read financial statements	4.0
Read diagrams, maps, or schematics	1.5
Write letters, memos, or emails	3.0
Write articles	5.0
Write reports	5.0
Fill in forms	2.0

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Numeracy Tasks (6 Items):

TASK	WEIGHT
Calculate costs or budgets	3.0
Use or calculate fractions or percentages	1.5
Use a calculator	1.0
Prepare charts, graphs, or tables	3.0
Use simple algebra or formulas	4.0
Use advanced math or statistics	5.0

For each worker, the composite score in each dimension is computed by summing the difficulty-weighted task indicators, where an indicator equals one if the worker reports performing the task with any frequency—that is, the response is not “never”—and zero otherwise:

$$S_{i,d} = \sum_k w_{k,d} \cdot \mathbf{1}[\text{task}_{i,k} \neq \text{never}]$$

where $S_{i,d}$ is worker's composite score in dimension $d \in \{\text{literacy, numeracy, ICT}\}$, $w_{k,d}$ is the difficulty weight for task k in that dimension, and the indicator equals one when the task is performed at least occasionally. These raw scores are then aggregated to the occupation-country level as weighted means using the PIAAC sampling weights (W), yielding the job skill requirement index $R_{o,c,d}$ for occupation o in country c along dimension d :

$$R_{o,c,d} = \frac{\sum_{i \in (o,c)} W_i \cdot S_{i,d}}{\sum_{i \in (o,c)} W_i}$$

Step 2 — Measuring Worker Skills

Worker skills are measured using the PIAAC cognitive assessment scores in literacy, numeracy, and problem solving in technology-rich environments. PIAAC reports ten plausible values for each domain to account for measurement uncertainty. We average across all available plausible values to obtain a single score per worker in each dimension.

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Step 3 — Global Normalization and Quintile Assignment

To enable cross-country comparison, both job requirement indices and worker skill scores are normalized to a common [0,1] scale using a min-max normalization pooled across all countries. Workers and occupations are then each assigned to one of five global quintiles based on their normalized scores in numeracy and literacy. Workers are assigned quintiles q_{num}^W and q_{lit}^W based on their cognitive assessment scores, while occupations are assigned quintiles q_{num}^J and q_{lit}^J based on their task-weighted job requirement indices. The resulting quintile pairs form the basis for match classification.

Step 4 — Match Quality Classification

For each employed worker, we compare their skill quintile vector to the quintile vector of their occupation's requirements across numeracy and literacy simultaneously. Match quality is defined as follows:

$$Match_i = \begin{cases} \text{Perfect} & \text{if } q_{num}^W = q_{num}^J \text{ and } q_{lit}^W = q_{lit}^J \\ \text{Good} & \text{if } |q_{num}^W - q_{num}^J| \leq 1 \text{ and } |q_{lit}^W - q_{lit}^J| \leq 1 \\ \text{Poor} & \text{otherwise} \end{cases}$$

A perfect match means the worker and their occupation fall in exactly the same quintile along both dimensions. A good match allows a gap of at most one quintile in each dimension simultaneously. A poor match is any case in which the gap exceeds one quintile in at least one dimension.

Workers classified as poor matches are further divided according to the direction of the mismatch in each dimension. A worker is classified as underqualified in a given dimension if their skill quintile falls below their job's requirement quintile, and overqualified if it exceeds it. Workers who are underqualified in both dimensions are classified as underskilled; those who are overqualified in both are classified as overskilled; and those whose mismatch directions differ across dimensions are classified as mixed.

All match quality shares are computed using the PIAAC sampling weights to ensure population representativeness. Results are reported separately for LAC countries—Chile, Ecuador, Mexico, and Peru—and the non-LAC OECD subsample, and are further disaggregated by employment type—salaried workers versus self-employed workers—and gender where sample sizes permit.

Appendix

Appendix 9 – Useful Definitions

TERM	DEFINITION
Active labor market policies (ALMPs)	Initiatives aimed at improving workers' labor market outcomes through skills development, job search assistance, and improved matching between job seekers and vacancies.
Allocative efficiency	The extent to which workers, capital, and other productive resources are allocated to the firms and sectors where they generate the highest productivity and economic value. When labor markets are allocatively efficient, more productive firms employ more workers and resources, while less productive firms remain smaller or exit.
Demographic dividend	The period during which the working-age population is increasing as a share of the total population.
Discouraged workers	Individuals classified as inactive who report not seeking employment due to discouragement, such as pessimism about job prospects, fatigue from previous job search efforts, or feelings of incapacity.
GDP per capita	Gross domestic product (GDP) divided by the total population. It measures average income or output per person.
GDP per worker	Gross domestic product (GDP) divided by the total number of employed persons. It measures average labor productivity, capturing output per employed worker.
Gig work	A single, nonrecurring job for which a worker receives payment to complete a specific task or work over a set time frame. Platform work is a type of gig work.
Human capital	The skills and knowledge possessed by the labor force. In this book, human capital is defined narrowly as the skills and educational qualifications that an individual possesses.
Independent workers	Individuals who are not employees, including self-employed workers and employers.
Labor accumulation	The increase in the size of the labor force over time.
Labor force	The economically active population, defined as individuals of working age who are either employed or unemployed.
Labor force participation rate	The percentage obtained by dividing the labor force by the working-age population, defined in this book as individuals ages 16 to 64.
Labor formality	An individual is classified as a formal worker if they are affiliated with or contributing to the social security system. In most countries, this classification is based on pension contributions; in others, such as Bolivia, the Dominican Republic, and Ecuador, it is based on enrollment in the health system through the individual's job.
Labor income	The sum of income derived from work in the main occupation.
Labor market gap	The share of individuals who are unemployed, underemployed, or discouraged workers, relative to the total number of economically active individuals and discouraged workers.
Monopsony power	A labor market situation in which employers have greater bargaining power than workers, allowing firms to set wages below workers' marginal productivity.

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TERM	DEFINITION
Part-time work	Employment involving fewer than 30 hours per week in which workers do not want to work additional hours.
Platform work	Paid work obtained through an online platform that uses algorithms to match workers with clients or tasks.
Self-employment	Work performed in one's own business or professional practice without hiring employees.
Severance pay	A payment made by an employer to an employee when the employee loses their job through no fault of their own.
Social security coverage	Coverage based primarily on contributions to a public or private pension system, typically linked to a person's main or secondary job. In some cases, coverage refers to enrollment in the social security or public health system, regardless of whether contributions were made during the reference period.
Telework	A work arrangement in which tasks are performed outside the employer's premises, typically from home or another remote location, using information and communication technologies (ICT) to carry out and coordinate work.
Technical and vocational education and training (TVET)	Education and training programs designed to prepare individuals for specific jobs or occupations.
Underemployment	A situation in which an individual works 30 hours or fewer per week in their main job, is available to work additional hours, and wants or is willing to work more hours (visible underemployment).
Unemployed	Individuals who did not work at least one hour during the reference period, are available for work, and have actively taken steps to find employment.
Unemployment insurance	A contributory insurance scheme that provides temporary income support to individuals who become unemployed.
Wage employment	Also referred to as wage or salaried employment, this category includes workers who are employed by a firm and receive a wage or salary in exchange for their labor.
Wage markdown	The percentage difference between a worker's marginal productivity and the wage they receive, reflecting the extent to which employers can pay wages below workers' productivity due to labor market frictions or monopsony power.



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