

Forces shaping the playing field for economic growth in Latin America

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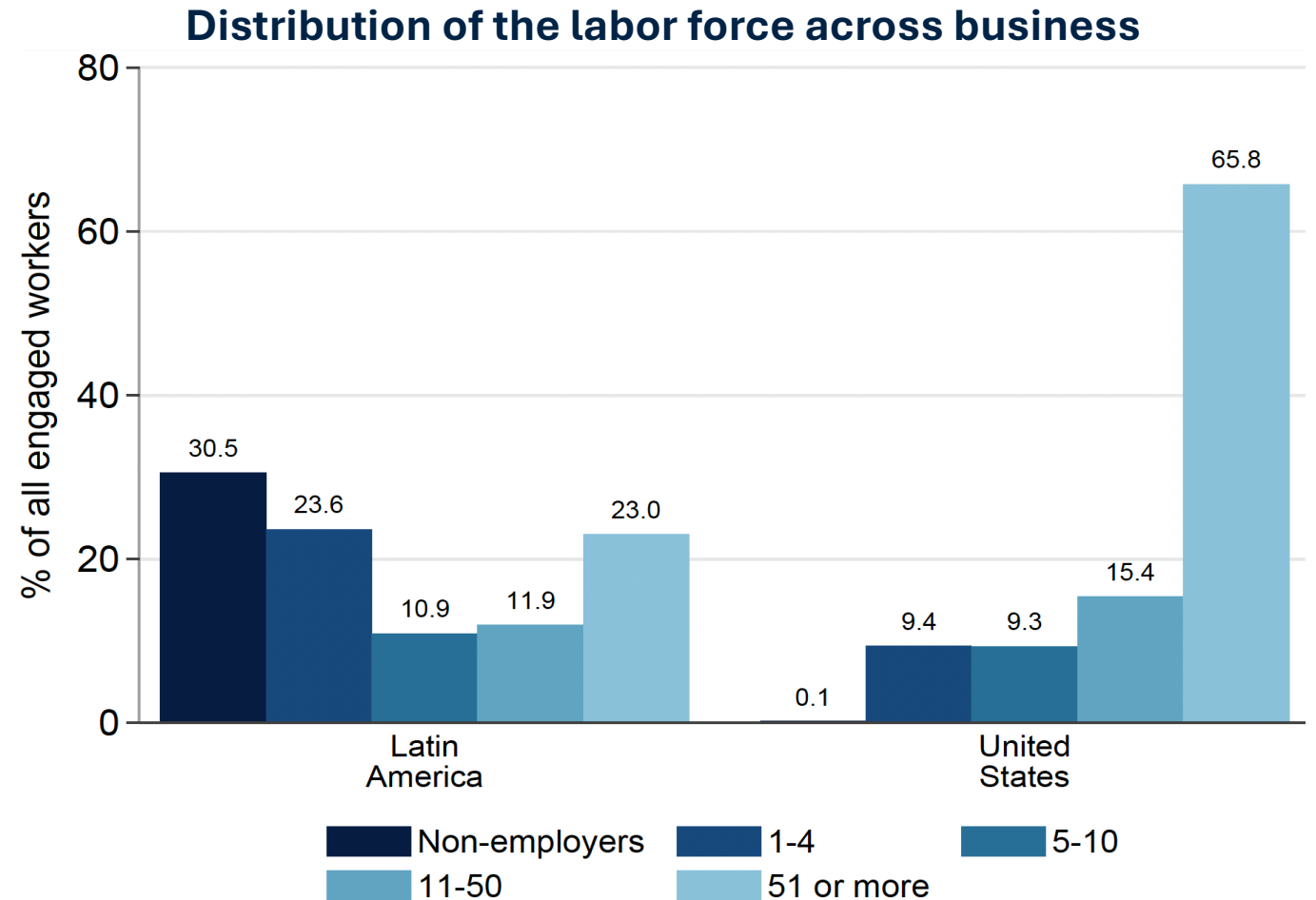
Making Reforms Happen in Latin America
Montevideo, November 17, 2025

In summary

- **Behind the region's mediocre growth is the shape of the business size distribution**—the high fragmentation of productive activity is associated with low productivity, low growth, and low incomes.
- **Regulatory frameworks are at least partially responsible** for this fragmentation. I will refer to labor and social protection rules and regulations, based on a detailed inventory of these regulations that we have put together for 11 countries. I will show that:
 - They translate into **high non-salary labor costs**.
 - **They vary** widely **across** and **within countries**.
 - They are **plagued by thresholds and discontinuities** that result in distorted incentives for growth.
- Weaknesses in regulatory design result from **forces behind different regulatory paths** pushing in opposite, often undesirable, directions. The challenge lies in aligning the visions of these different groups to “make the necessary reforms” happen.

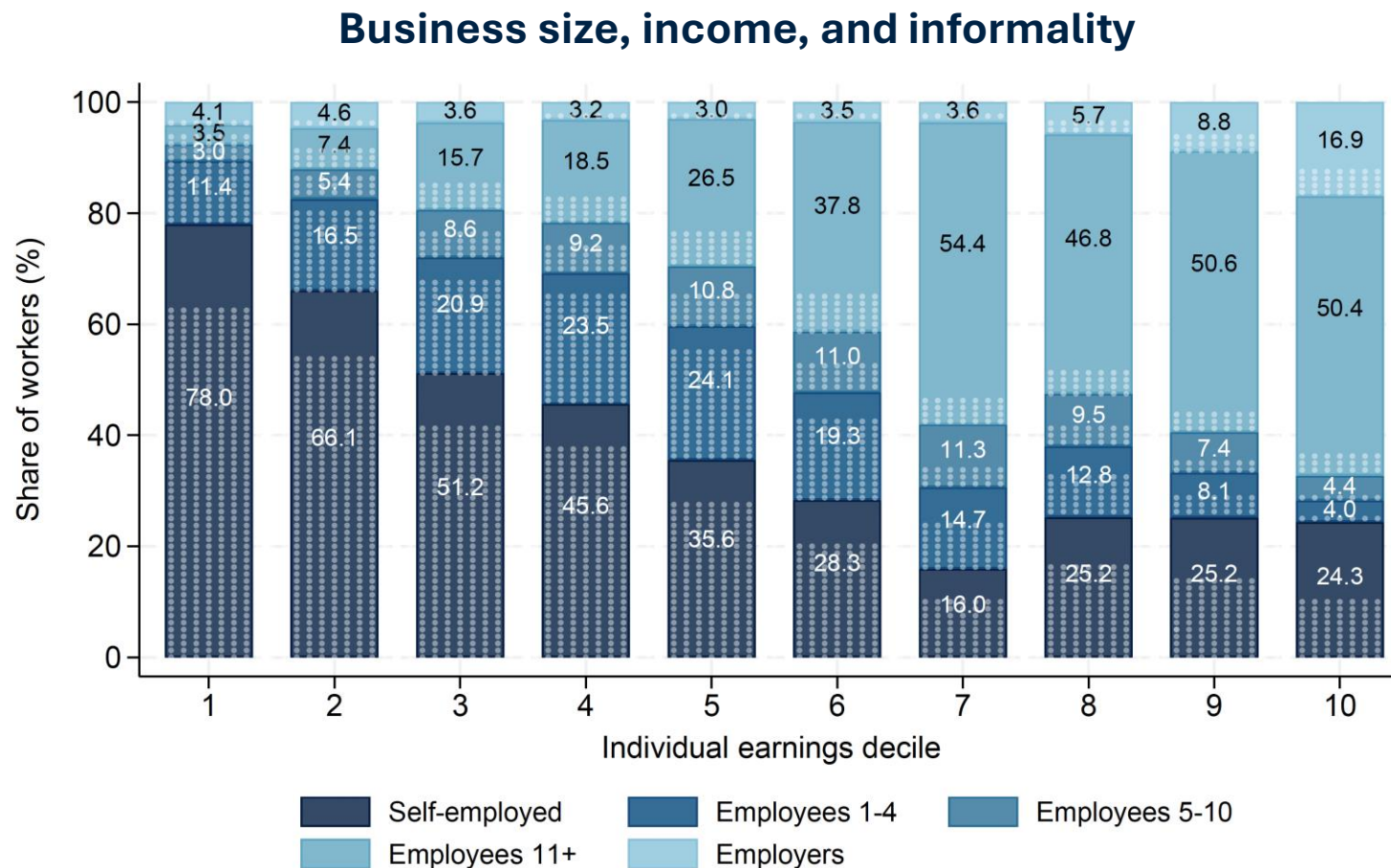
The region has yet to consolidate a large segment of small, medium, and even large businesses

- Businesses with up to 10 workers, including one-person businesses, account for 65% of the workforce in LATAM.
- This contrasts with 20% in the US in the same size group —66% of workers in the US are in businesses with more than 50 employees.



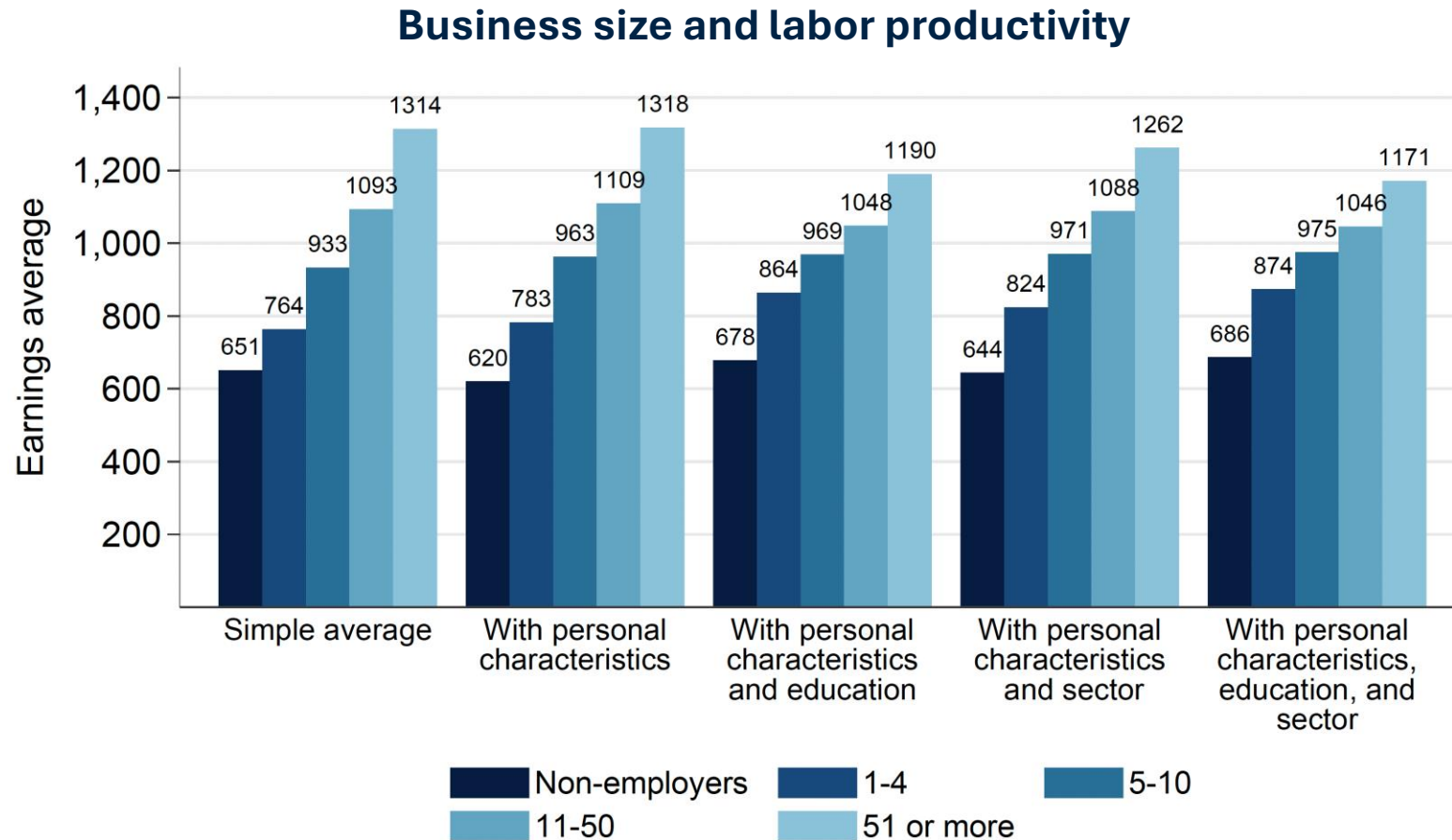
Business size is positively correlated with both earnings and formality

- **Most low-earning workers** in Latin America are **self-employed** or work in **businesses with fewer than five workers**, and most of them do not contribute to health insurance or old-age pensions – they are informal.
- In contrast, most high-earning workers are formal salaried employees in businesses of more than 10 workers.



Labor productivity, measured by average earnings per worker, increases with business size

- Comparable workers earn 70% more in businesses with more than 50 workers than in one-person businesses. And businesses with 1 to 4 workers result in higher average earnings than self-employment (27%).
- Market power cannot explain gaps in earnings across the smaller size categories. Those gaps are more likely explained by differences in productivity.



Source: Authors' calculations using National Household Surveys for 2023 (2022 for Argentina, Chile, Dominican Republic, and Mexico; 2019 for Honduras). This figure presents a weighted average of country-level regression coefficients across various econometric specifications. Weights are given by the total number of observations in each country.

If Latin America succeeded in creating a facilitating environment for the creation of more salaried employment through the emergence and growth of larger businesses (of 10 to 50, and 50+ workers), able to absorb the workforce currently scattered in tiny productive units into better jobs, the face of poverty, informality, inequality, and productivity in the region would change.

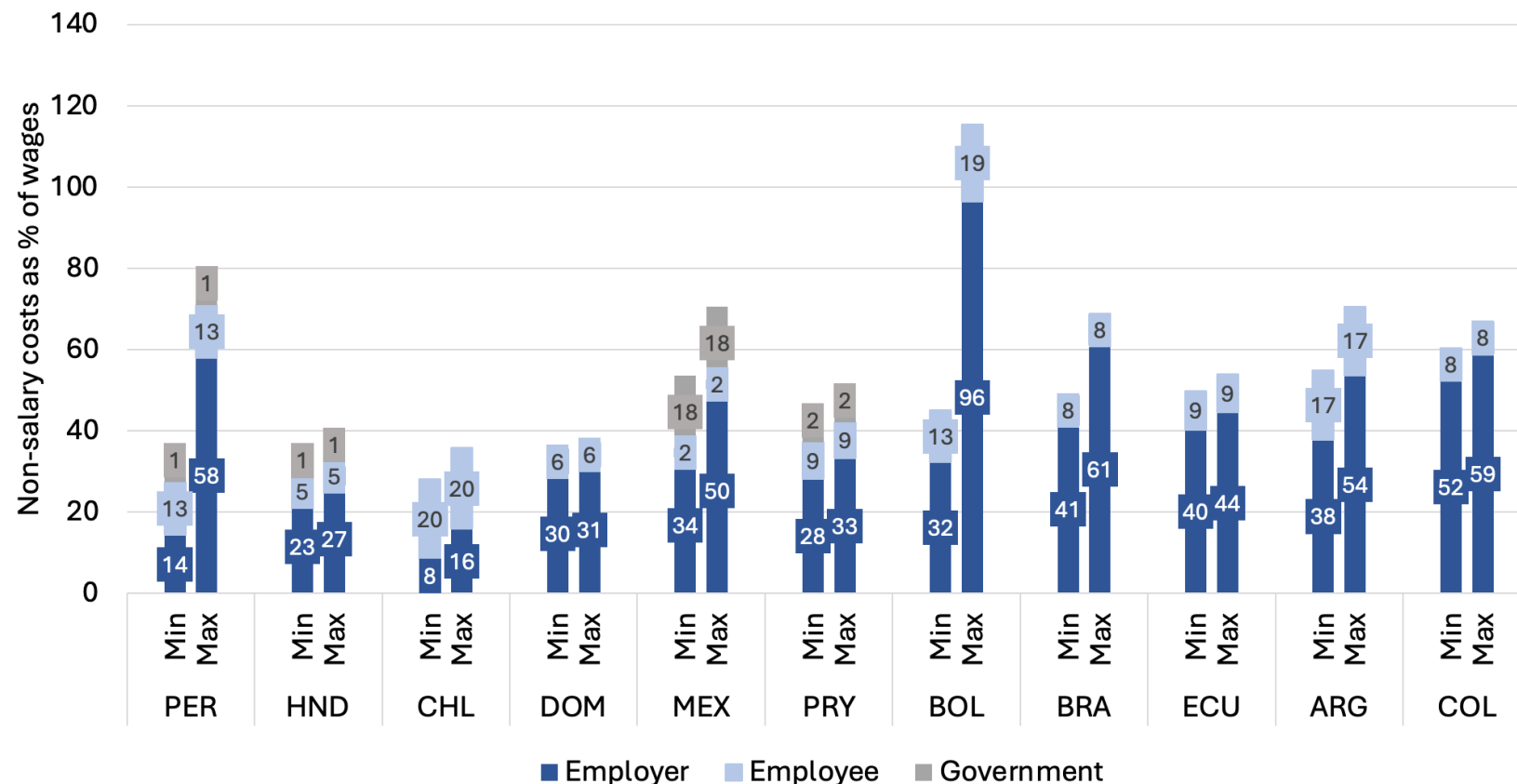
Labor, social protection, and tax rules are among the potential factors that keep the region in this undesirable equilibrium of highly fragmented markets.

Non-salary labor costs vary significantly **across workers and firms *within*** countries.

They also **vary across countries** and are **very high in some** of them.

Non-salary labor costs as a share of wages for minimum wage earners, 2025

Minimum and maximum possible costs



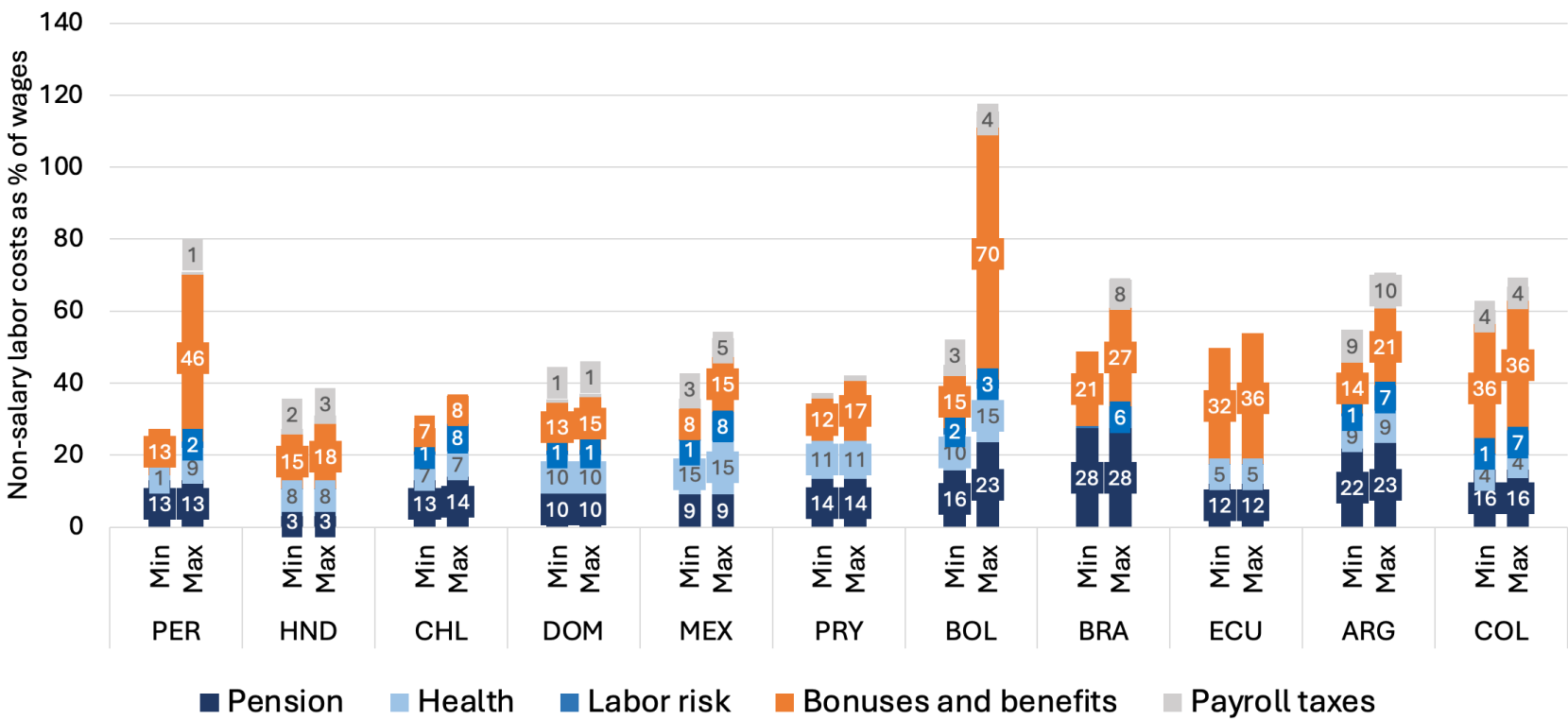
Source: Labor and social protection regulatory frameworks and authors' calculations.

Bonuses and benefits account for the **largest share of non-salary labor costs** and are the **primary source of variation** in non-salary labor costs **within countries**.

Their weight is lowest in Chile and Mexico (under 30%), and highest in Ecuador (65%). It is also near or above 60% *for some worker/business types* in Bolivia, Colombia, Honduras, and Peru.

Non-salary labor costs as a share of wages for minimum wage earners, 2025

Minimum and maximum possible costs, by type



Source: Labor and social protection regulatory frameworks and authors' calculations.

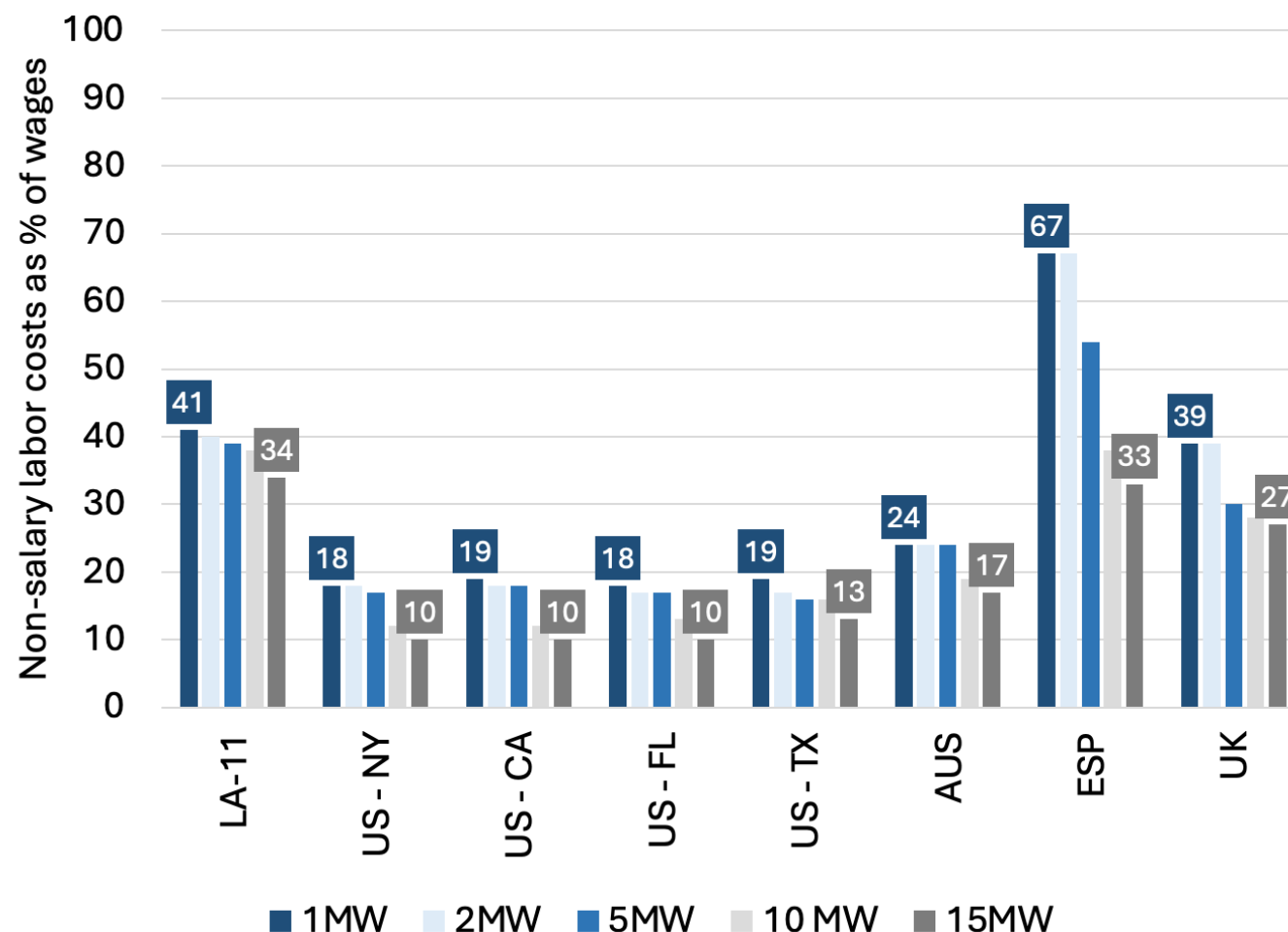
The **Latin American average of 41%** is 2 p.p. higher than the UK level, 22 p.p. higher than the US, and 26 p.p. lower than Spain.

The **tendency everywhere is to reduce non-salary costs as salaries increase**, but the rate at which this decrease occurs varies across locations.

The **US and the UK stand out for almost no variation** between the minimum and maximum (not shown).

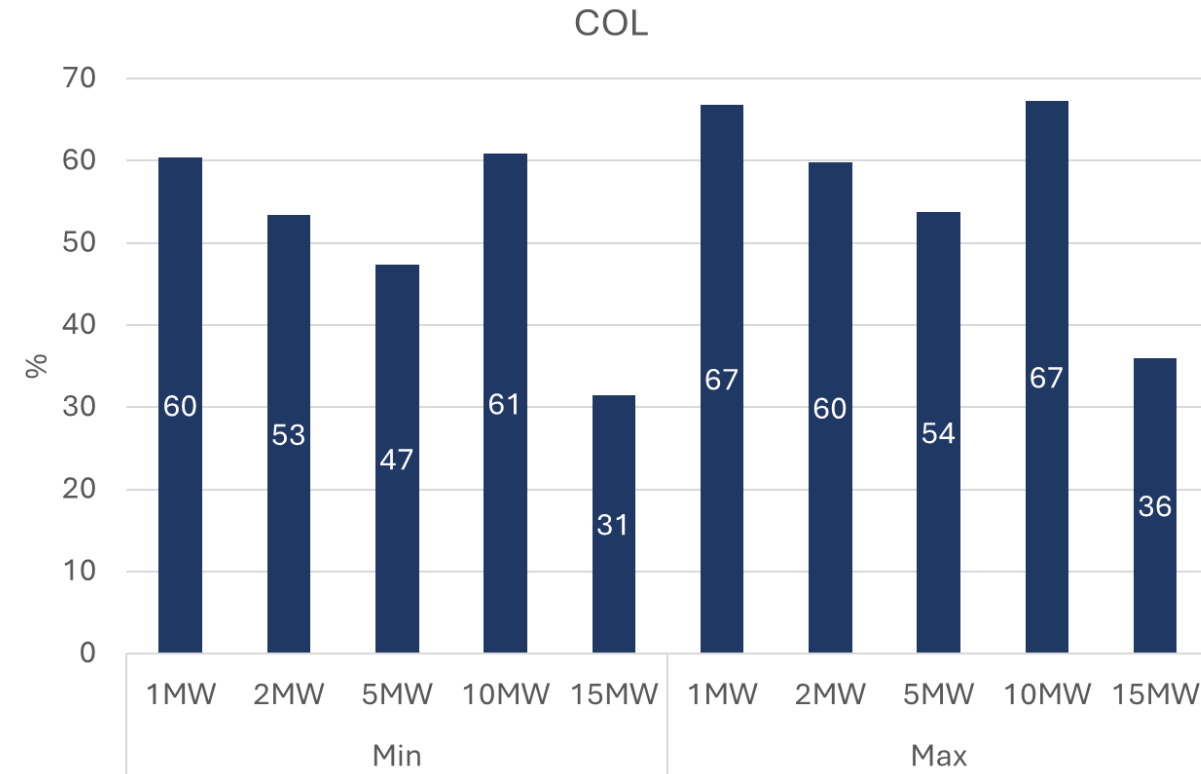
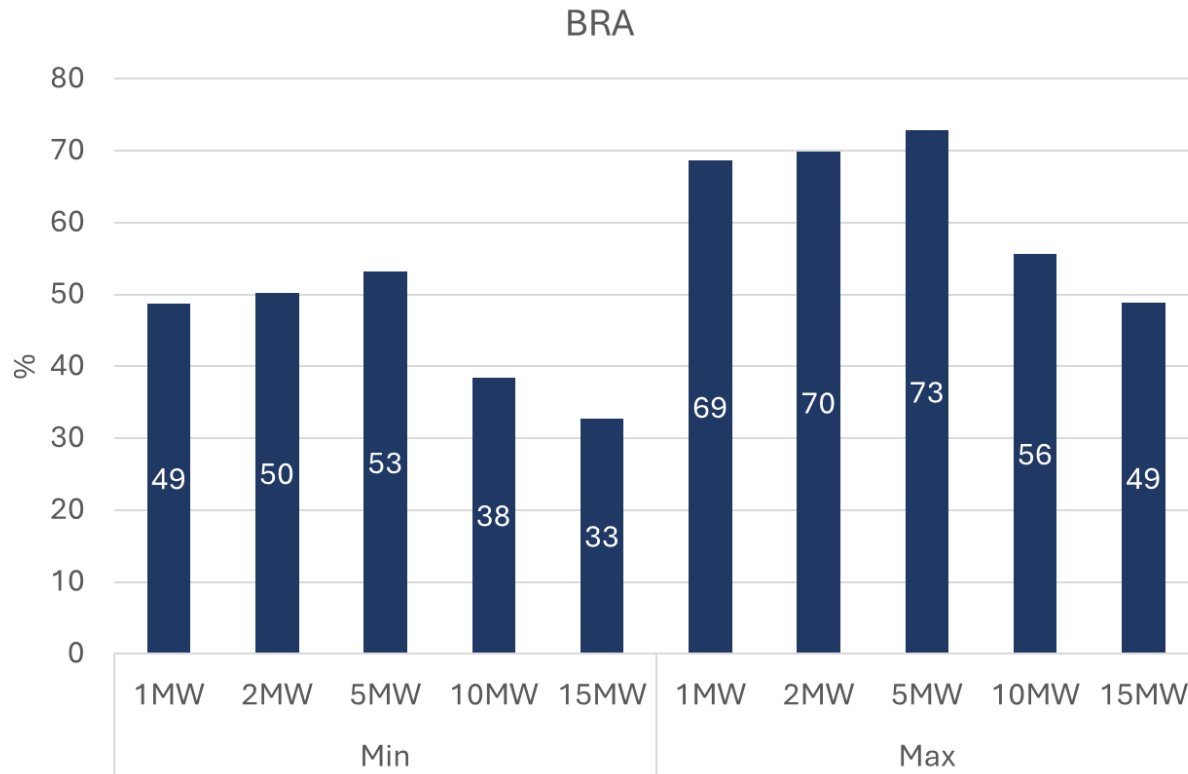
Non-salary labor costs as a share of wages by wage level, Latin America and comparators, 2025

Minimum possible costs



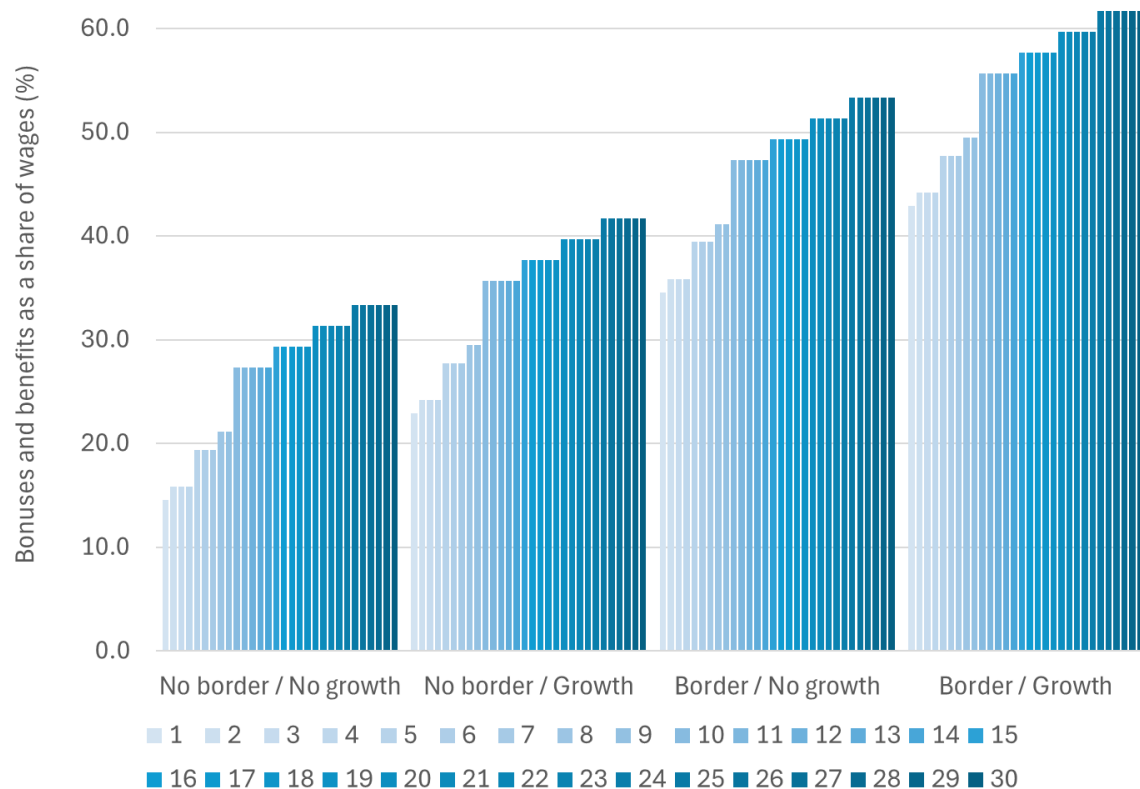
Source: Labor and social protection regulatory frameworks and authors' calculations.

Variation patterns across wage level categories differ across countries and are not well reflected by the group averages

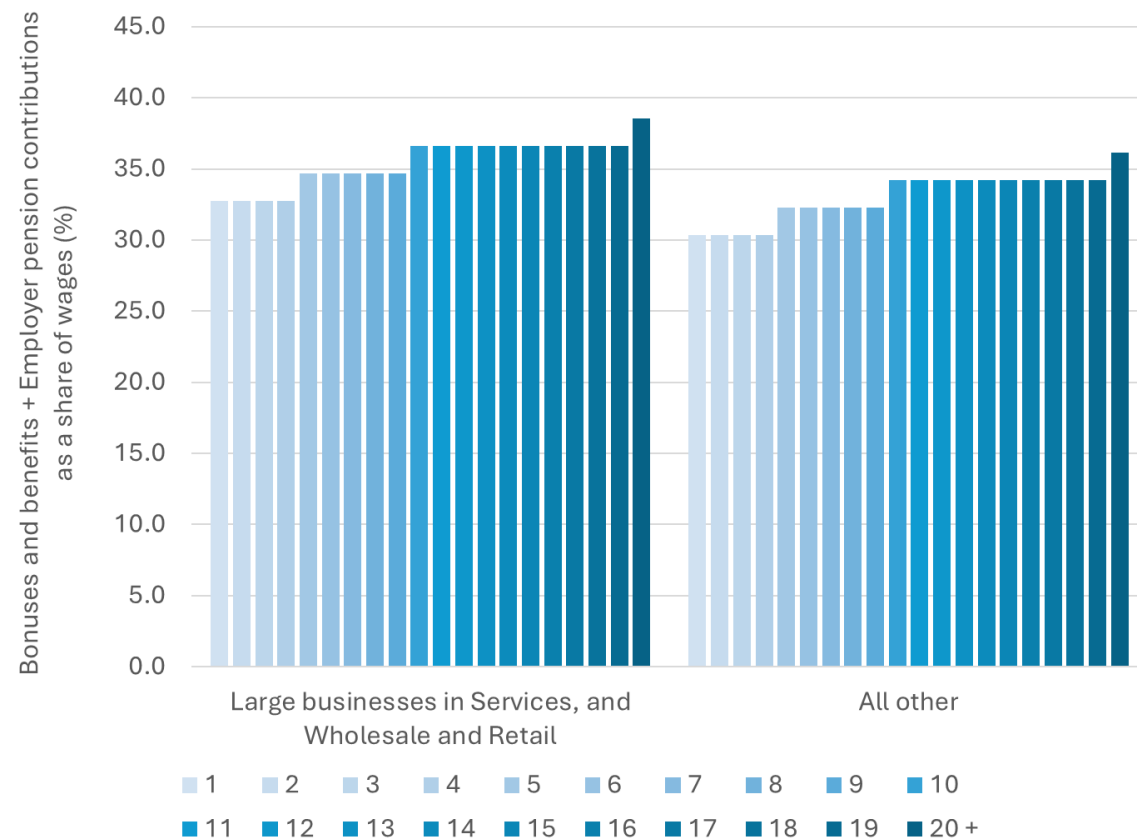


Distortive incentives are associated with discontinuities in the form of thresholds at which regulatory treatment changes.

Bonuses and benefits in Bolivia



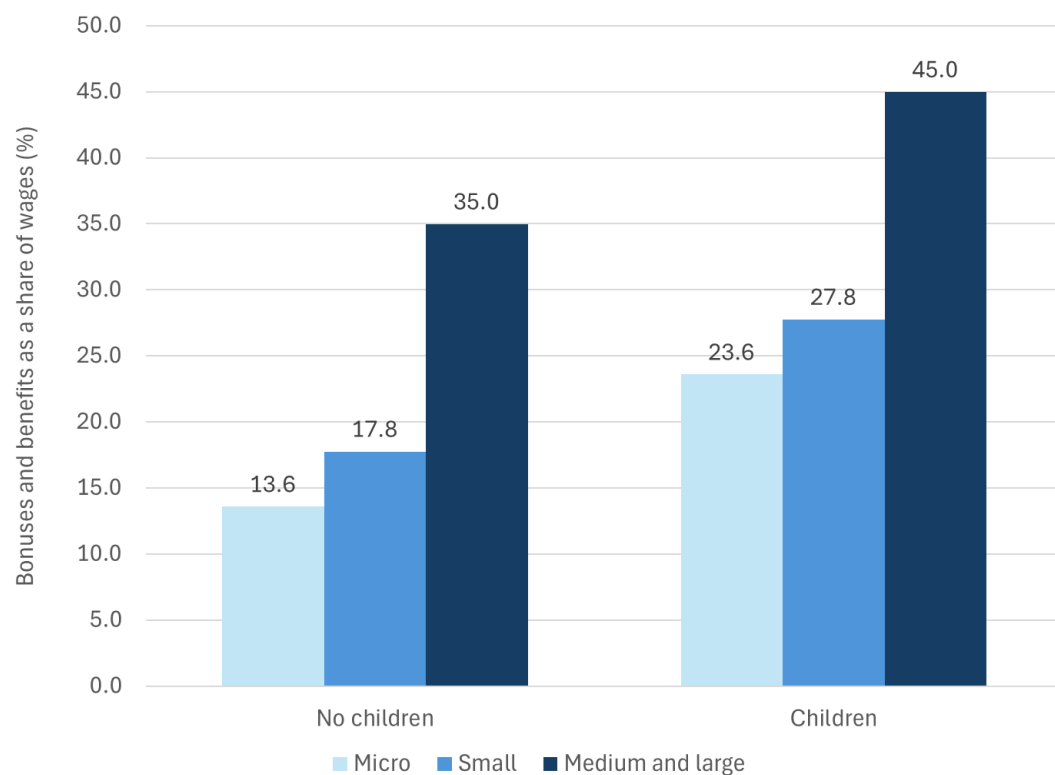
Bonuses, benefits, and pension contributions in Argentina



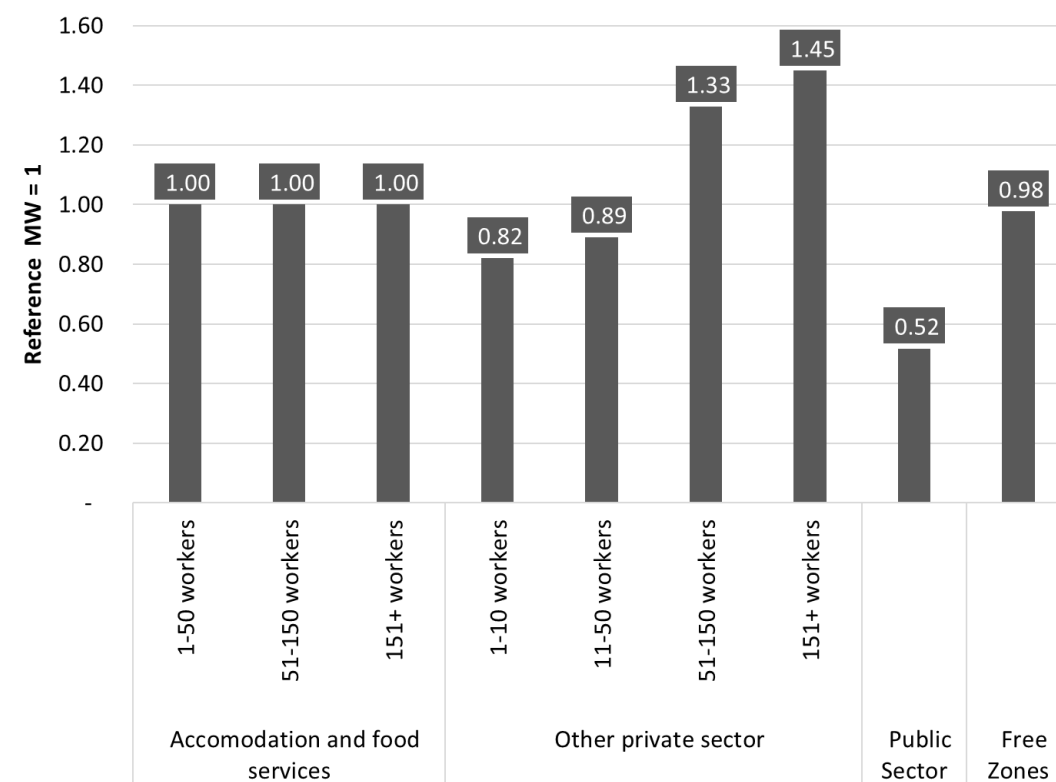
Source: Labor and social protection regulatory frameworks and authors' calculations.

Distortive incentives are associated with discontinuities in the form of thresholds at which regulatory treatment changes.

Bonuses and benefits in Peru



Minimum wages in the Dominican Republic



So, we have labor and social protection regulations that..

- Impose a heavy burden on formal employers.
- Are highly complex (!)
- Tilt the playing field against businesses in some sectors of activity, larger businesses, businesses located in certain territories, and businesses with more experienced, longer-tenured workforces.
- De facto, they:
 - Act as industrial policies, favoring some sectors over others.
 - Distort location choices.
 - Punish business age and worker experience.
 - Punish business growth.
 - Punish the employment of certain worker types.
 - Are regressive—they impose higher costs as % of wages for lower-wage earners.

How did we get here?

Three lines of reasoning may explain regulatory choices, which are in collision with each other:

1. Granting **bonuses and benefits to improve workers' conditions** (for example, rewarding tenure lengths or mandating businesses to provide specific services to their employees), **redistributing from businesses to formal workers, and increasing the costs of formal labor.**
2. **Helping businesses by reducing the non-salary costs of the higher-earning employees, by allowing differential treatments** depending on sector or location, or by **redefining “formal”** to include tiny businesses in the system.

The **lack of coherence in purpose** across the different regulations, present in most countries in the sample, can perhaps **be traced back to the influence of opposing interest groups—workers and employers—at different moments in time**, which, in the absence of strong views from policymakers and regulators, have resulted in regulatory patchworks.

How much variation in non-salary labor costs across workers and businesses is justified?

Forcing **redistribution from employers to formal employees is desirable in cases of market power imbalances**. This applies to a limited number of businesses (the largest) that can pay wages lower than those considered fair.

Labor union victories vindicate formal worker rights and enhance the benefits associated with formal employment. But a line must be drawn between regulatory measures that protect essential rights and those that grant excess benefits.

- In high labor informality contexts, large shares of workers are excluded from these conquests. Increasing the costs of formal work makes their transition into formal work arrangements even harder.
- High non-salary costs can also undermine formal work, shrinking the set of workers who benefit from the regulation.

Regulations that provide special treatment to specific worker types often hurt those they intend to benefit. There is hardly a justification to make some workers less or more costly than others in the eyes of business.

How much variation in non-salary labor costs across workers and businesses is justified?

- Regulations intended to ease the burden on business must also be carefully designed to ensure that they
 - Do not unlevel the playing field for business, giving an advantage to certain players at the expense of others.
 - Do not incentivize the fragmentation of productive activity – do not bring along incentives for businesses to remain small, trumping their natural expansion paths.
 - They do not introduce regressivity by placing a higher relative burden on the lower- than the higher-income workers.
- Under both lines of reasoning, however, one thing matters the most: that regulations don't add unnecessary complexity to the regulatory environment that businesses and workers face. It is impossible to comply with regulatory requirements that are hard to implement or understand.

Thank you
