

Extending Social Insurance to Informal Workers

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Outline

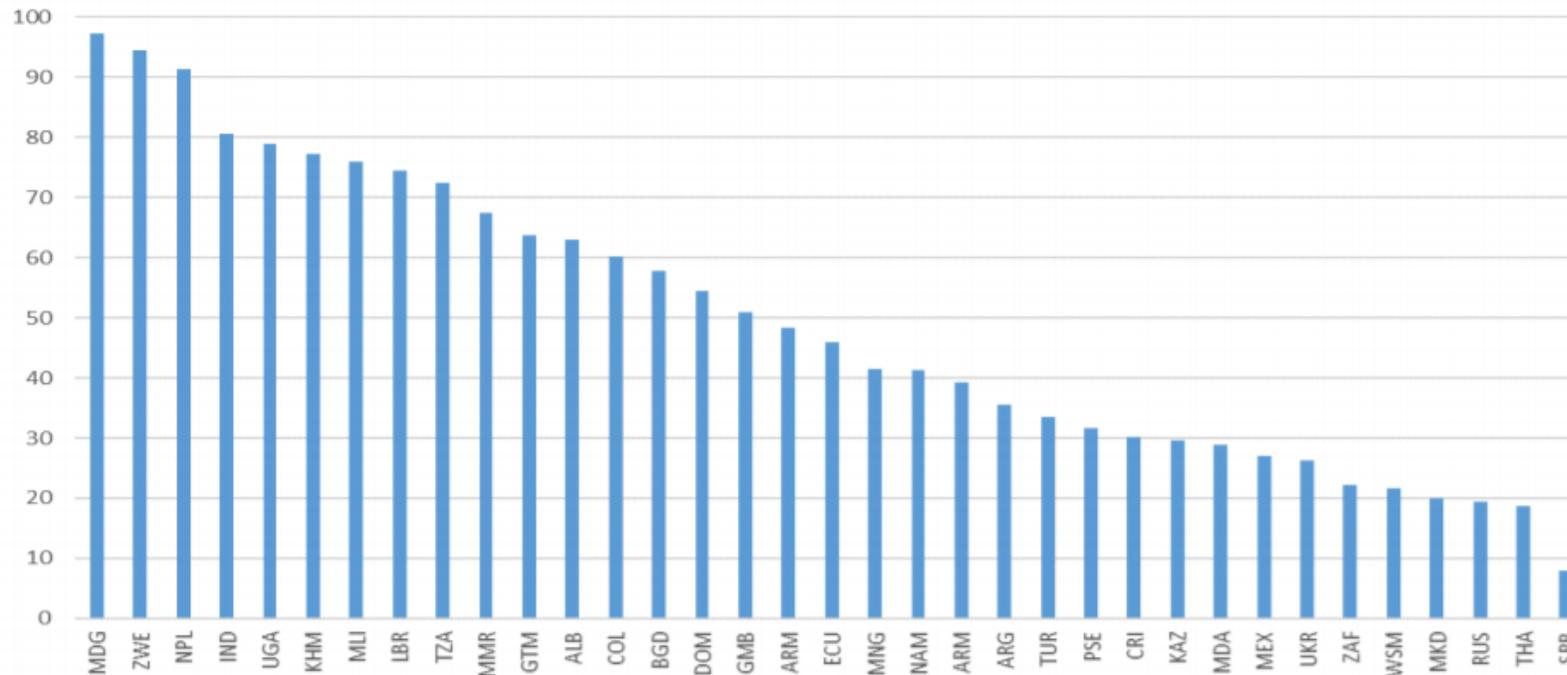
- Why do we care?
- What is social insurance?
- Why should governments intervene?
- Trade-offs
- Design, Implementation and Policy Options
- Conclusions

Why do we care?

Why do we care?

Figure 1

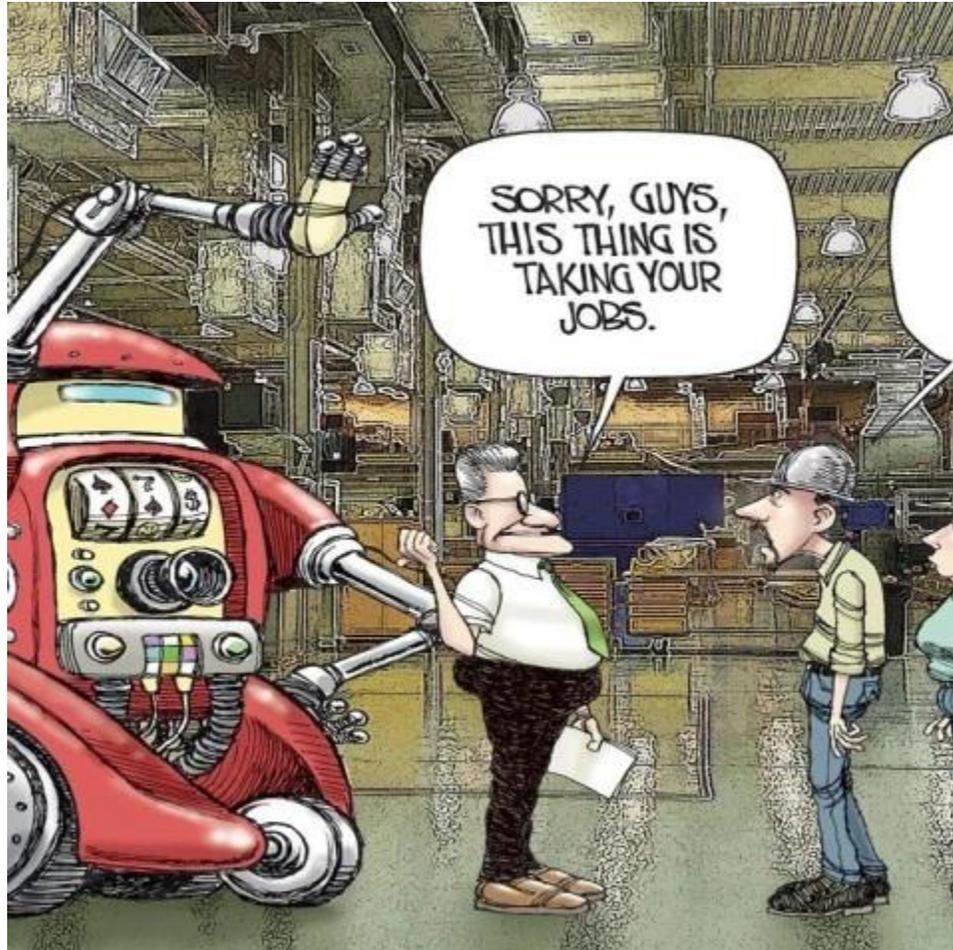
Snapshot of Informal Employment around the World (% of total employment)



Source: ILOSTAT. Informal employment comprises all workers of the informal sector (in unregistered firms) and informal workers outside the informal sector (own-account workers, and employees not contributing to social security, paying income taxes, or who lack certain benefits such as family leave or sick leave).

Many workers in developing countries are not covered against important risks, such as unemployment, illness and old-age poverty

Why do we care?



Jobs are changing!

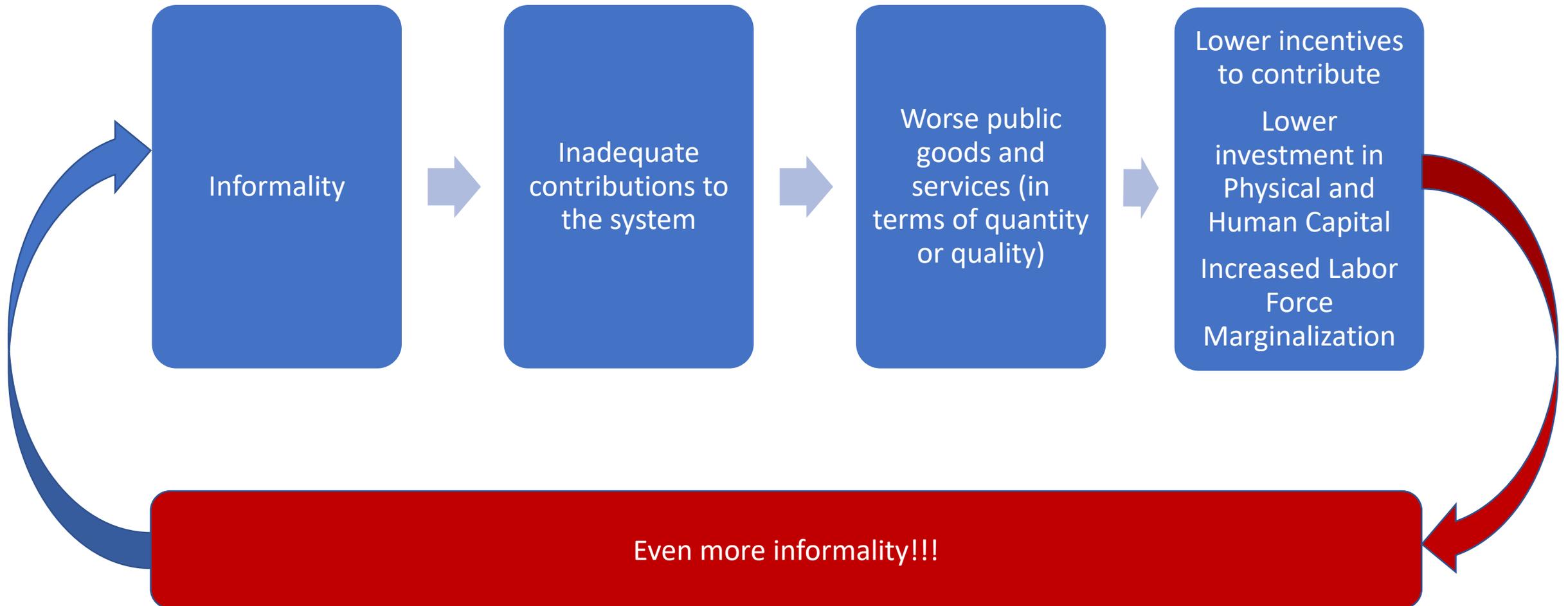
Freelancing gives me the flexibility to panic about my job instability anytime I want.

someecards



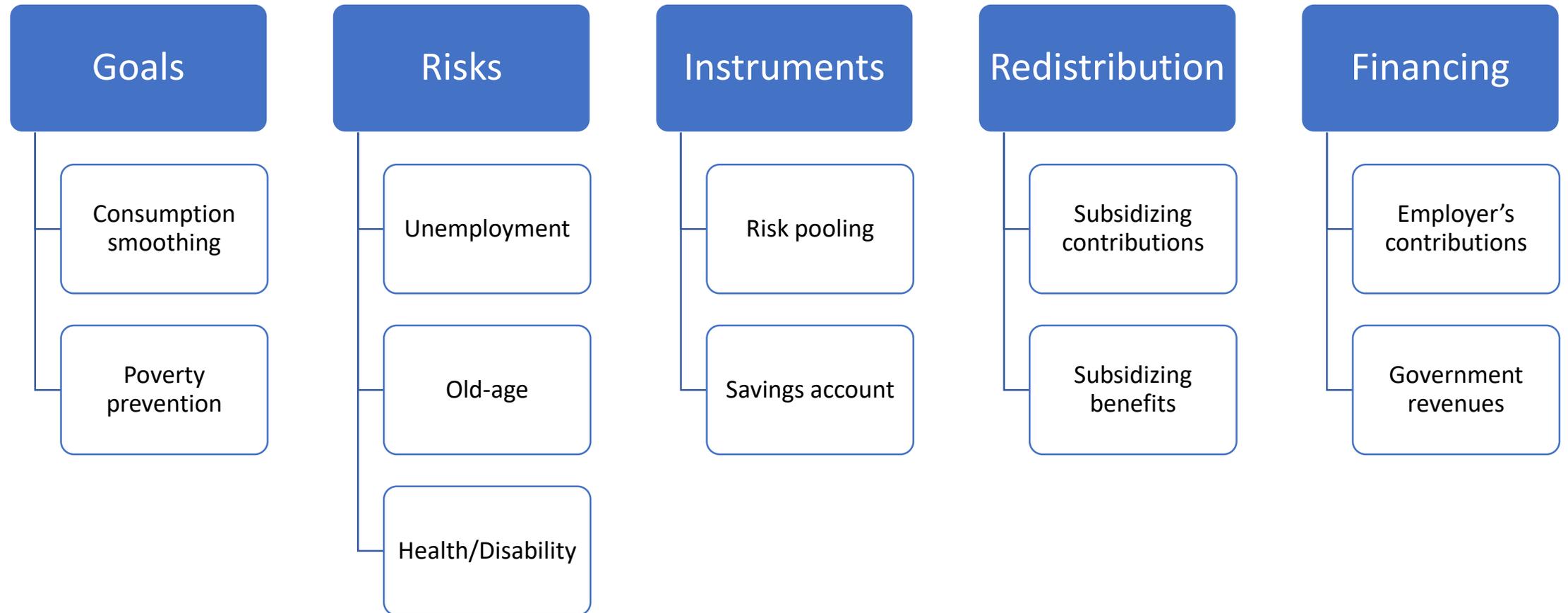
Why do we care?

Informality and lack of economic opportunities are part of a vicious circle



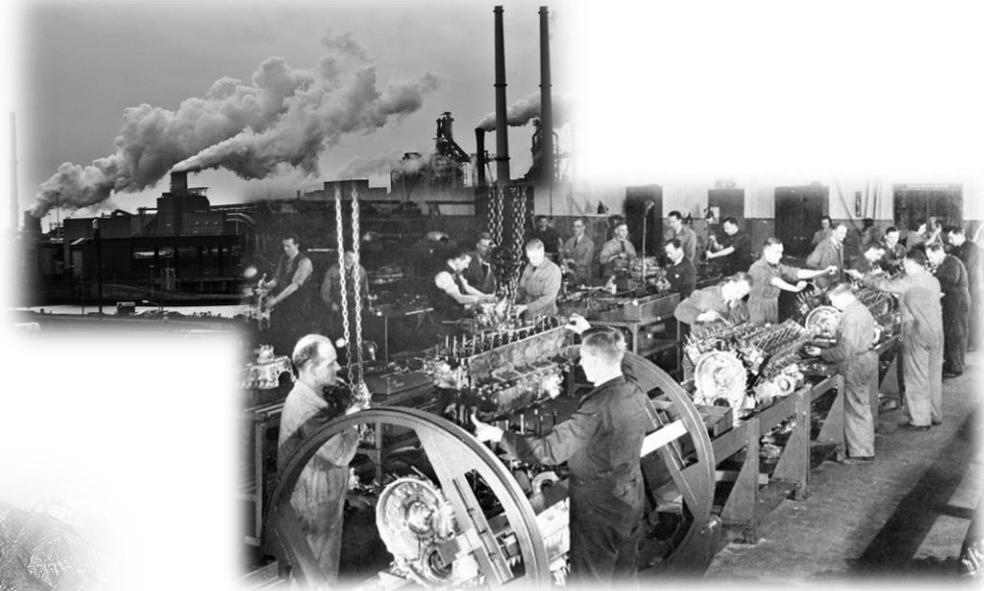
What is social insurance?

What is Social Insurance?

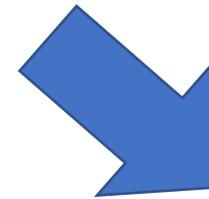


Extending social insurance to informal workers: How did rich countries do it?

From agriculture...



To wage employment
in manufacturing....



To wage employment
in high-skilled services



Can history be repeated in developing countries?



Why should governments intervene?

Why should governments intervene?

- Because the private sector would not provide the socially optimal amount of insurance:
 - Insurance market failures
 - Myopia
 - Poverty traps

Insurance Market Failures

Adverse Selection



Pre existing conditions

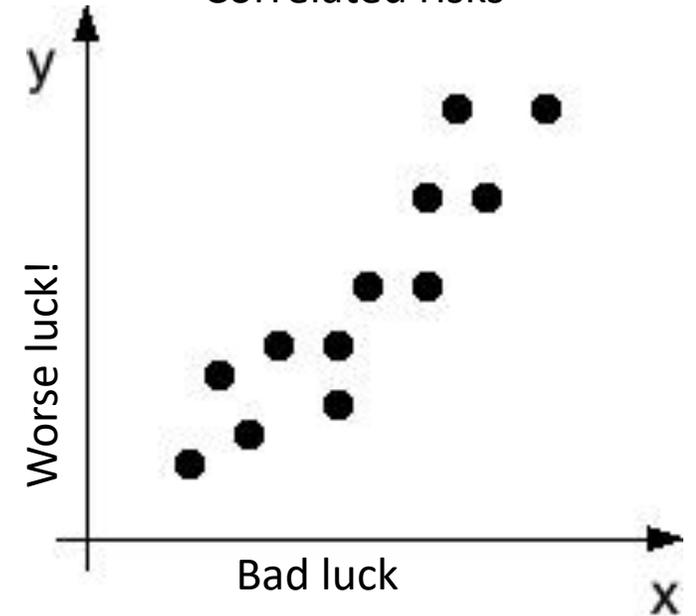


Moral Hazard



"Really, Mr. Claus, you can't work one night a year then expect to qualify for unemployment benefits."

Correlated risks



Myopia

- Lack of information
- Lack of awareness
- Financial illiteracy
- Barriers to accurately weighting risks
- Psychological barriers to long-term planning



Poverty traps



Social Insurance's trade-offs

Social insurance trade-offs

Increasing coverage....



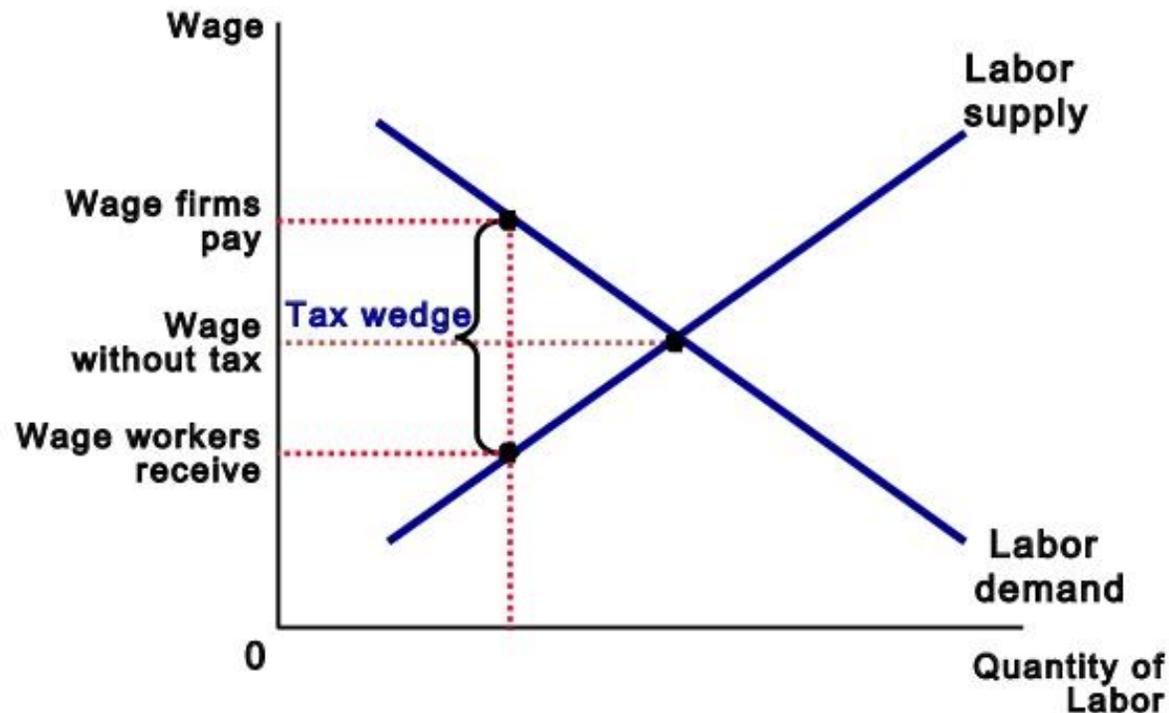
Destroying jobs?

Available options

- Bismarckian system
- Non-contributory universal programs
- Parallel programs
- Integrated Systems: Bismarckian + Redistribution

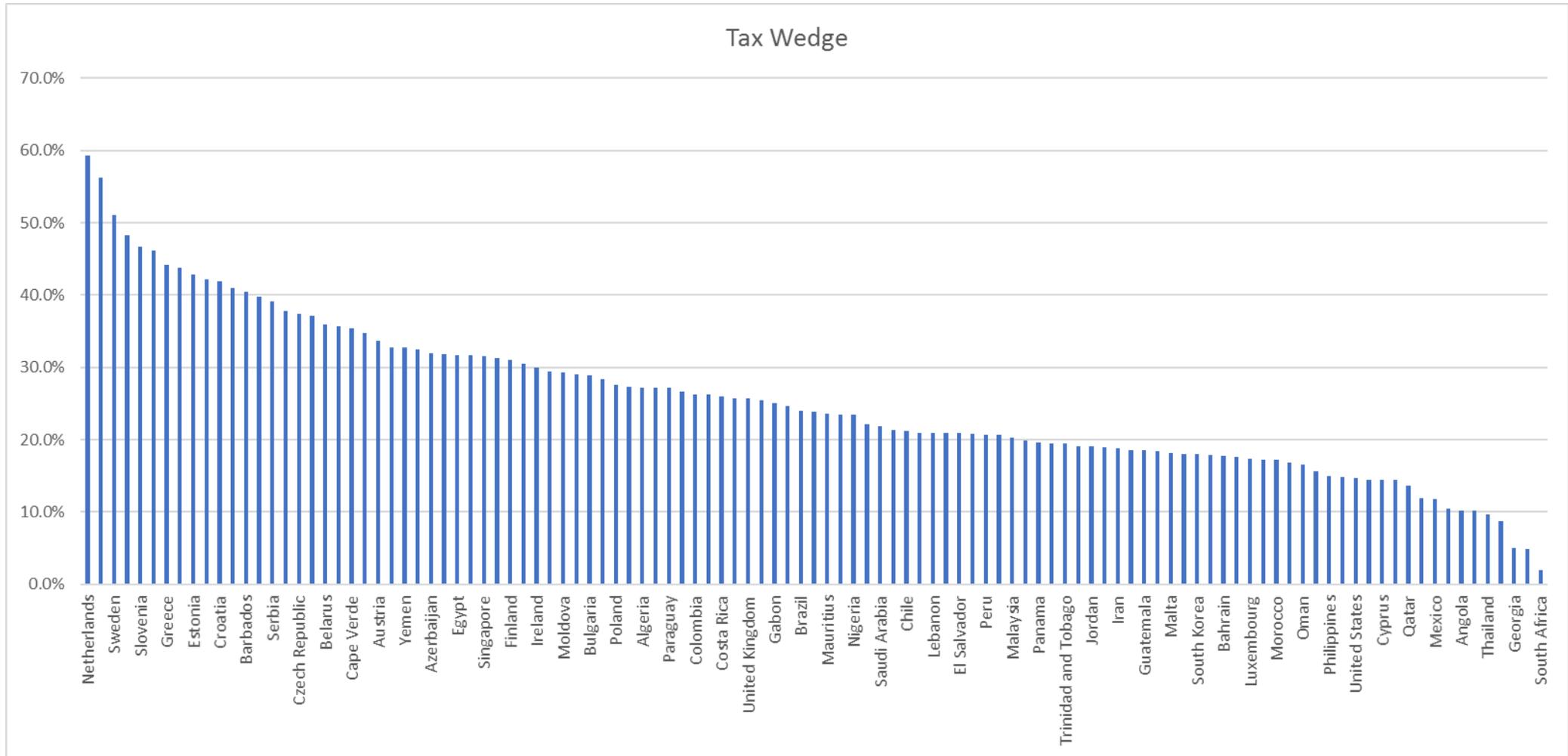
When linked to the labor market (*Bismarckian system*)...
Social Insurance programs can distort labor supply and demand

A Payroll Tax



The **tax wedge** creates a gap between the wages firms pay, and workers' take-home pay.

Tax-wedge across countries



Tax wedge: Perceived vs. Actual

The *perceived* tax wedge is large if...

- Individuals do not value the redistribution mechanism
- Services are of poor quality, benefits are low
- Excessive bundling of benefits that individuals do not value
- Contributions are not linked to benefits
- Myopia

Potential negative effects of the tax wedge

- Higher unemployment by:
 - Reducing labor demand
 - Reducing labor supply by increasing early retirement, inactivity
- Higher informality
- Lower job mobility

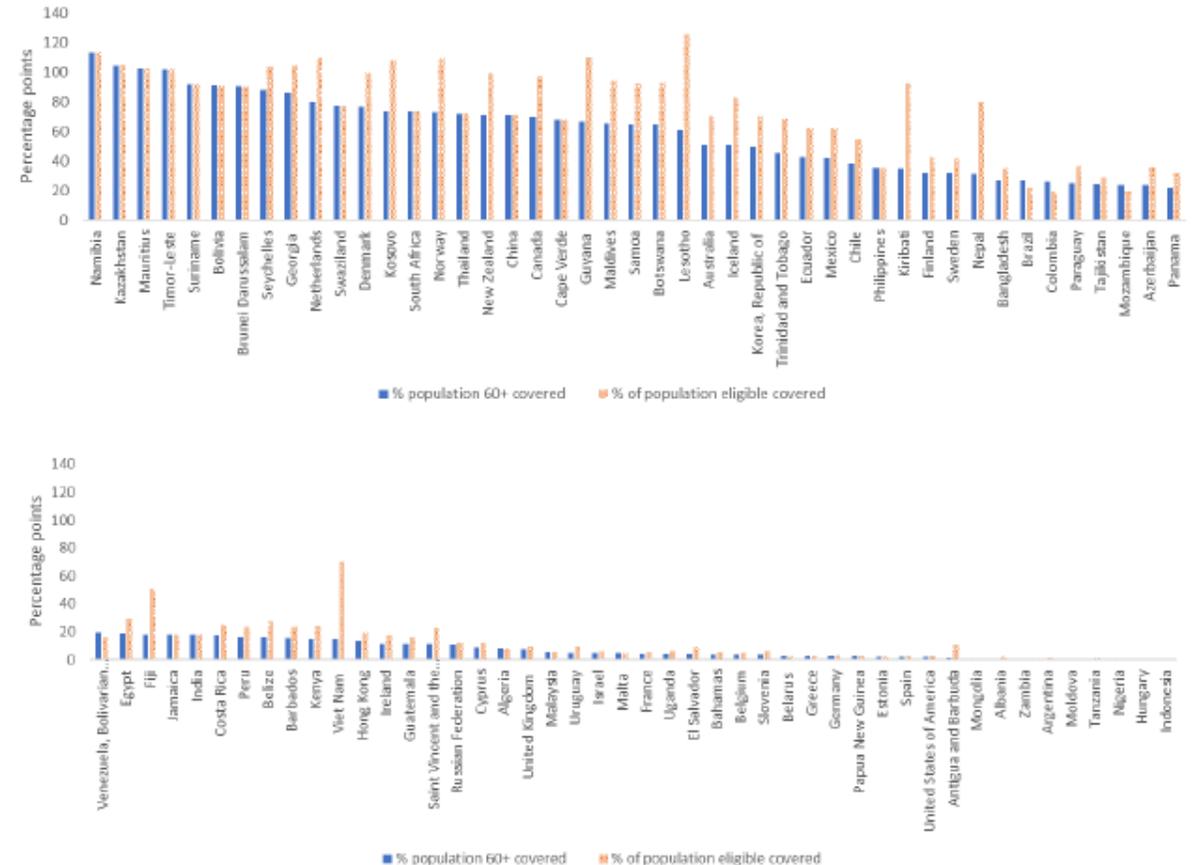
Bismarckian systems did not perform well in developing countries

- In response, three models have emerged:
 - Non-contributory universal programs
 - Parallel schemes
 - Integrated national programs

Non-contributory universal programs

- They include social pensions, universal health insurance and unemployment assistance where eligibility is not based on past contributions and is instead financed out of general taxation

Figure 2
Social Pension Coverage across the World



Source: Based on data from HelpAge International, Social Pensions Database

Non-contributory universal programs

- Pros:
 - They don't create disincentives to change jobs
 - When well-designed, they are progressive.
- Cons:
 - They can add important fiscal pressures because benefits are typically not linked to revenues
 - They may crowd out individual savings
 - They may create disincentives to work, and to work formally



Empirical evidence on the impacts of non-contributory universal programs

- Mexico's Seguro Popular:
 - While the program was successful at achieving good coverage, it also increased informal employment between 0.4 and 1 percentage points, which is equivalent to 8-20% of net formal job creation during the 2002-2010 period.
 - The program was associated with an increase of flows from work to inactivity, and a decline of flows out of unemployment, suggesting that Seguro Popular made inactivity and unemployment more attractive.
- Colombia's health program:
 - Total informality rates increased between 2 to 4 percentage points.
- Chile's basic social pension:
 - The introduction of a basic social pension for workers with insufficient contributions had a negative effect on labor market formality, with the reform leading to a reduction in formal employment of 4.1 percent for workers older than 40 years old. The reform also increased the propensity for women with children to drop out of the labor market due to the income effect associated with the pension subsidy for each child.
- Universal pensions in South Africa and Mexico lowered labor market participation among eligible people.
- Universal health insurance in Thailand reduced formal employment

Parallel schemes

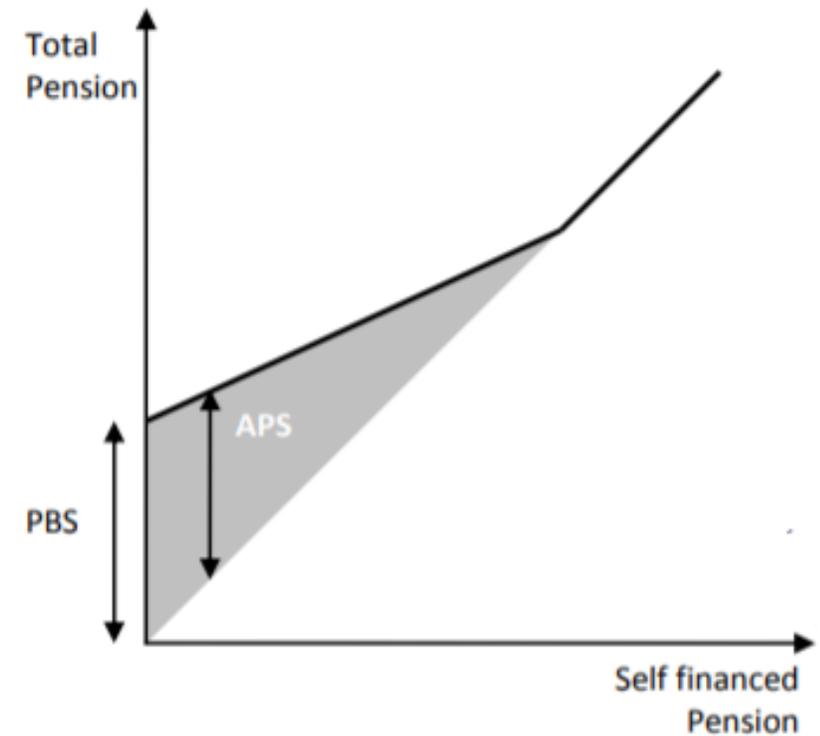
- Include those where several fragmented contributory systems coexist
- Include cases where a Bismarckian system coexists with non-contributory program, where eligibility for the former depends on labor market status and workers cannot be included in both simultaneously
- Pros:
 - They could be adapted to the particular situation of workers in different occupations and sectors
 - When well designed, they could be more progressive
- Cons:
 - Affect mobility decisions
 - More prone to be regressive and distortive when highly fragmented

Integrated national programs

- Some governments have reinforced the solidarity mechanism by integrating a Bismarckian system and new social insurance schemes aimed at including informal workers, into a single system for beneficiaries across the income spectrum.
- They, in principle, address the limitations inherent to parallel and universal noncontributory schemes by being more financially sustainable and not exacerbating labor market distortions that constrain labor mobility.

Integrated systems: The case of Chile's pensions

- Savings component:
 - Benefits and contributions are strongly linked.
- Solidarity component:
 - All individuals in the 60% less affluent fraction of the population will have a guaranteed basic pension, regardless of their contribution history.
 - Individuals with no contributions are entitled to an old-age Basic Solidarity Pension (PBS), once they reach 65 years of age, and fulfill the affluence and residence requirements.
 - Individuals who made contributions but will receive a pension below a certain threshold (the maximum pension with solidarity complement, PMAS) are entitled to a Pension Solidarity Complement (APS), with the same affluence and residence requirements¹



But even integrated systems can generate distortions...

Does this mean there is no role for the government?

NO!



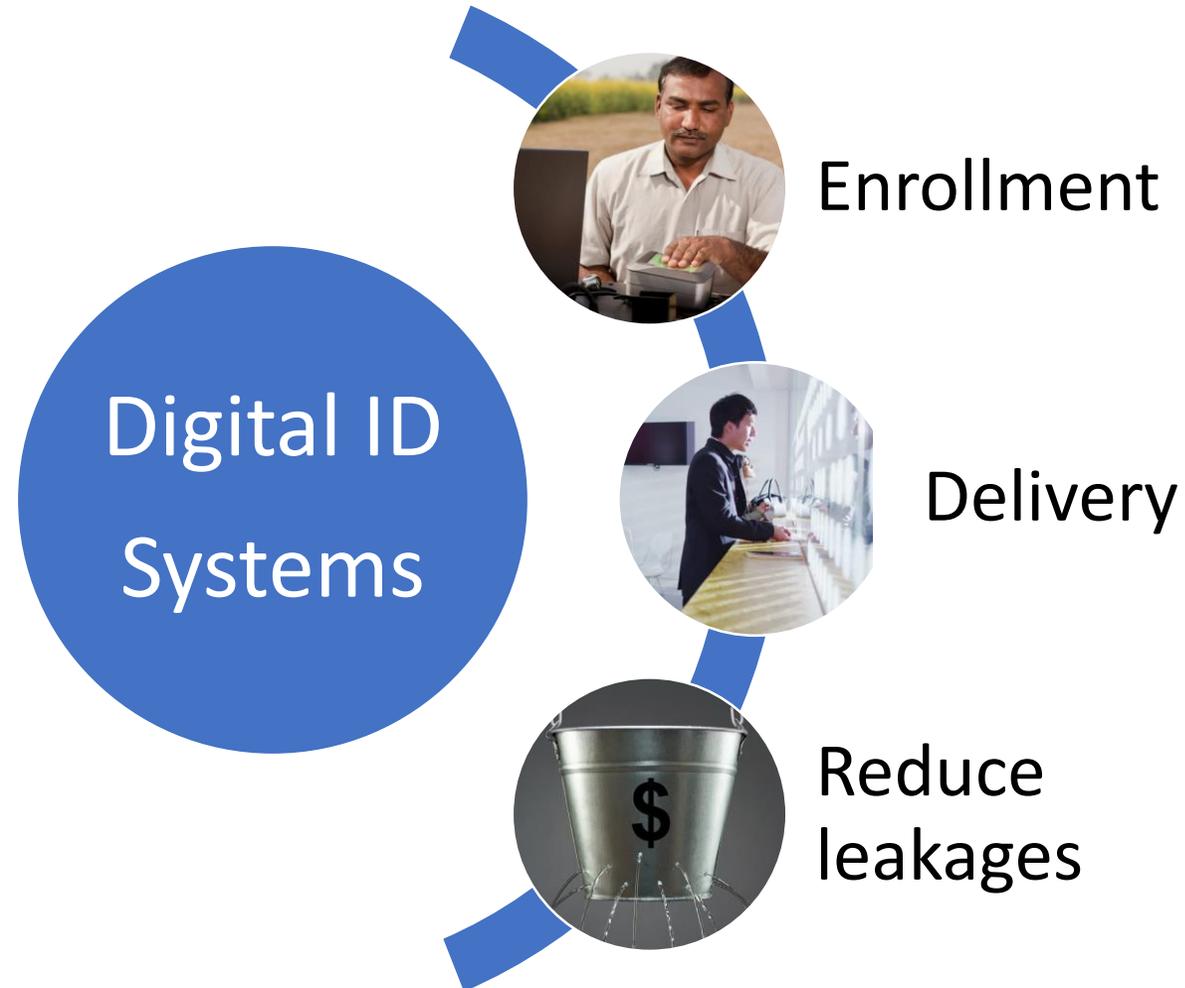
But there has to be a balanced approach



It is impossible to design social insurance mechanisms and protect workers without changing economic incentives

Design, Implementation and Policy Options

REGISTERING AND ENROLLING WORKERS (1)

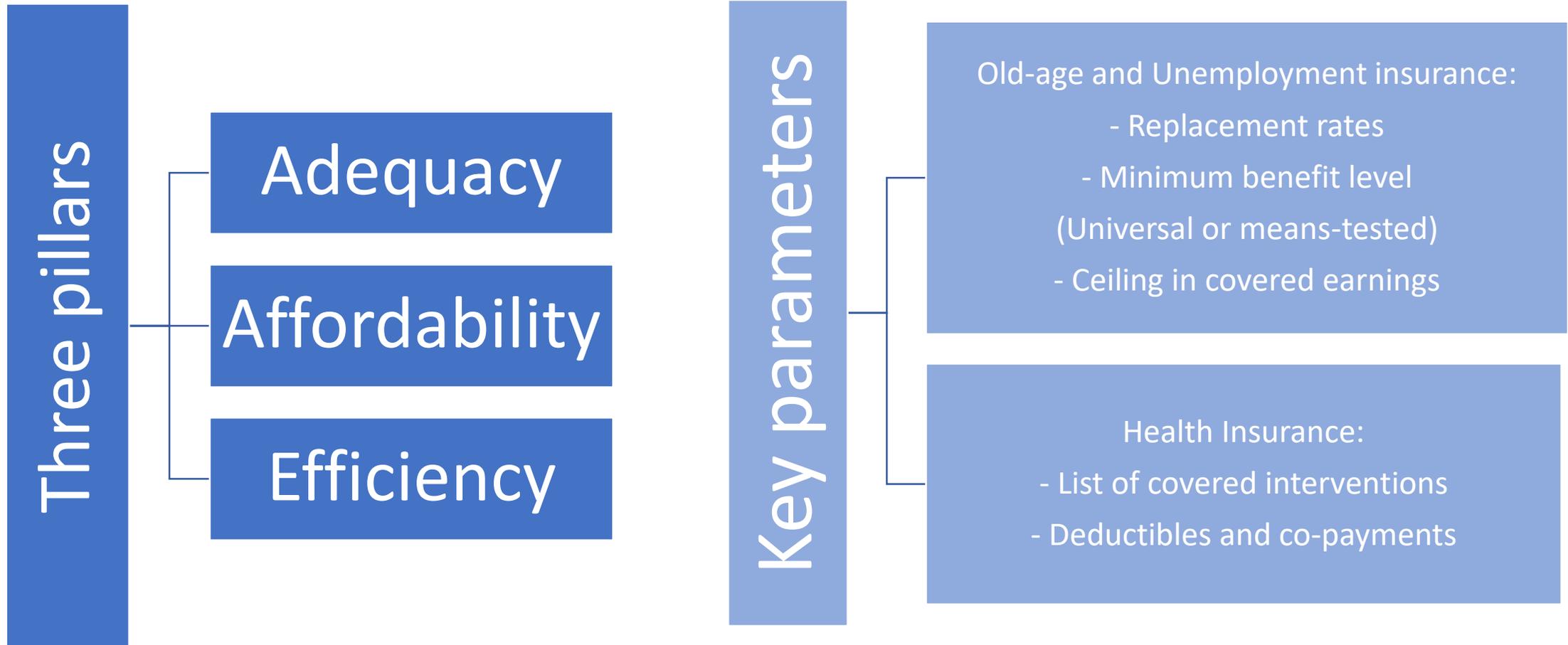


REGISTERING AND ENROLLING WORKERS (2)

Instruments to foster voluntary enrollment:

- Enrollment subsidies
- Dissemination campaigns
- Minimize and simplify enrollment
- Make payments easier
- Affordable premiums
- High quality and quantity of benefits

LINKING CONTRIBUTIONS TO BENEFITS

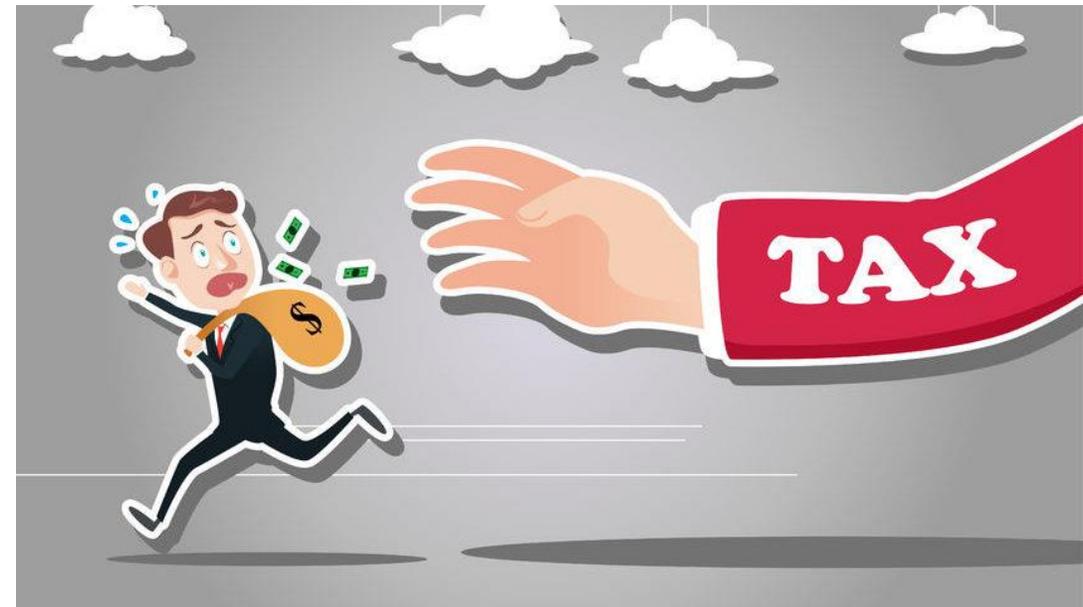


PROVIDING INFORMATION AND INCENTIVES TO CONTRIBUTE/SAVE

- Communications campaigns
- Financial literacy
- Financial incentives
 - Matching contributions
 - Ex-ante transfers
 - Ex-post transfers
- Non-financial incentives

MONITORING AND ENFORCEMENT

- Adequate monitoring and enforcement capacity is crucial
- But too much enforcement can have some unintended consequences, specially if inspections are inefficient or affected by corruption



Conclusions

- There are efficiency and equity reasons to extend social insurance to informal worker
- Given the existence of market failures, government intervention is justified
- The Bismarckian system in its pure form cannot be easily extended in developing countries
- Integrated systems that combine savings account with a redistributive component seem like the most viable option

Time to test our knowledge!

Which alternative is worse?

Policy		Impacts on		
	Parameters	Informality	Public Finance	Equity
Introduction of non-contributory health insurance in a country with an existing Bismarckian system	(1) Healthcare quality is significantly worse for non-contributing workers			
	(2) Healthcare quality is the same for all people			

Which alternative is worse?

Policy		Impacts on		
	Parameters	Informality	Public Finance	Equity
Poor retirees get a supplemental pension in a country with an existing Bismarckian system	(1) Every eligible retiree gets the same supplemental pension			
	(2) The supplemental pension for eligible retirees is higher for those who made additional contributions			

Which alternative is worse?

Policy		Impacts on		
	Parameters	Informality	Public Finances	Equity
There is no Bismarckian system, and a non-contributory health insurance is introduced	(1) Coverage is conditional on being unemployed			
	(2) Universal coverage			

For more information check

