

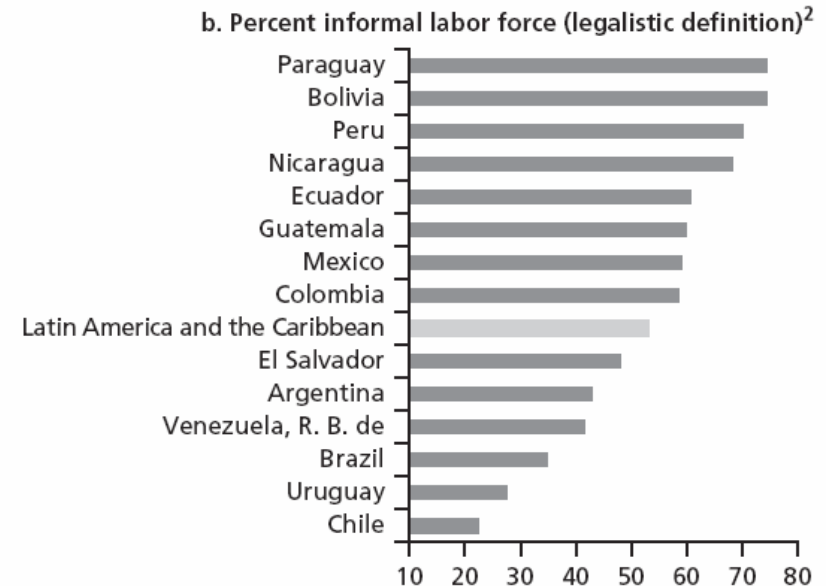
Pension Fund Coverage and the Informal Sector in Latin America

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Concept of Informality

- What we understand by “Informality” may differ according to the circumstances:
 - Non-salaried workers (including self-employment)
 - Workers not paying taxes (hidden economy)
 - Workers not covered by social insurance.
 - Rural entrepreneurs.

Measures of Informality



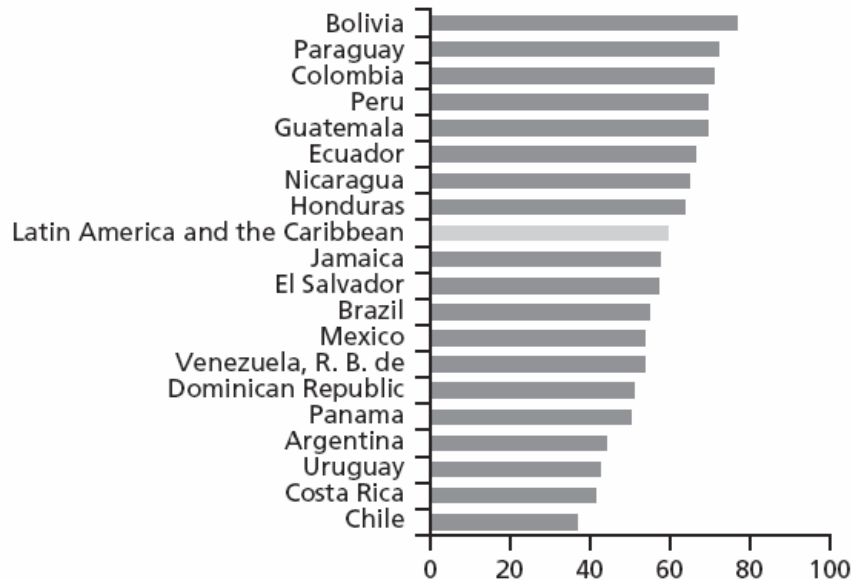
Sources: Gasparini and Tornarolli 2006; investment climate surveys 2006; Loayza and Rigolini 2006; Schneider 2005; World Bank 2006b.

Note: 1. Informality is measured by the percentage of sales that businesses do not report for tax purposes (Investment Climate Surveys 2006).

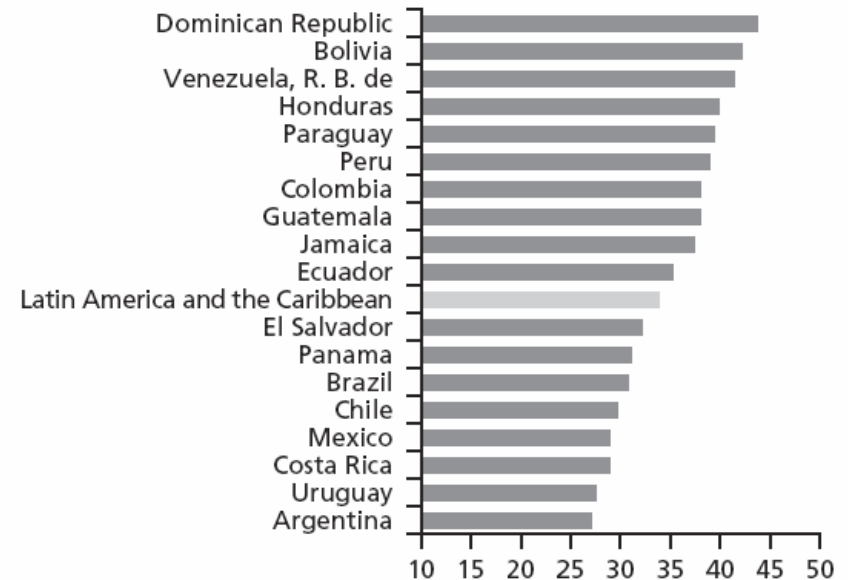
2. "A salaried worker is informal if s(he) does not have the right to a pension linked to employment when retired" (Gasparini and Tornarolli 2006, 10).

Measures of Informality

c. Percent informal labor force: Productive definition (% employed)³



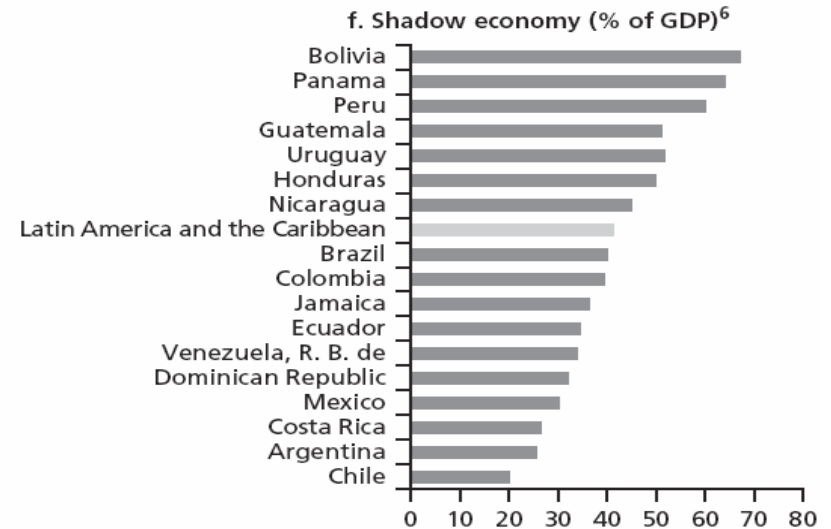
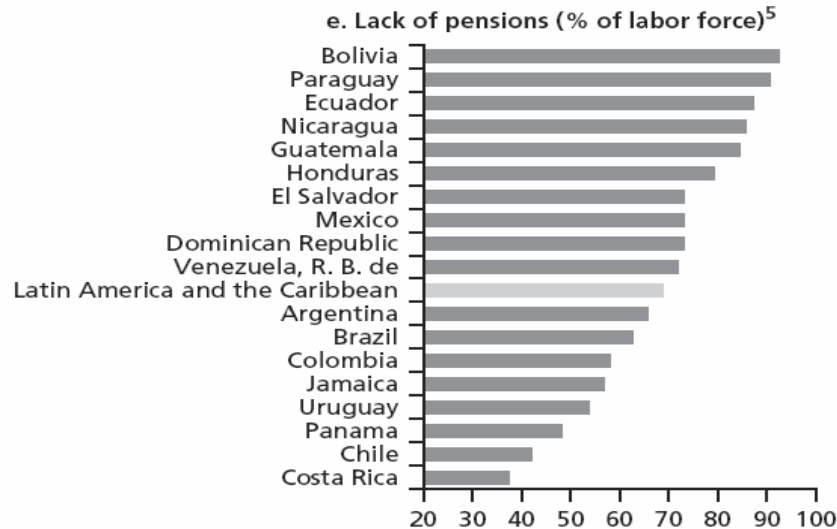
d. Self-employment (% of labor force)⁴



3. "An individual is considered an informal worker if (s)he belongs to any of the following categories: (i) unskilled self-employed, (ii) salaried worker in a small private firm, (iii) zero-income worker" (Gasparini and Tornarolli 2006, 8).

4. "Self-employment is measured as the percentage of self-employed workers with respect to the total active population" (Loayza and Rigolini 2006, 15).

Measures of Informality



5. Share of the labor force not covered by a pension scheme (World Bank 2006b).

6. "The shadow economy includes all market-based legal production of goods and services that are deliberately concealed from public authorities for the following reasons: (1) to avoid payment of income, value added or other taxes, (2) to avoid payment of social security contributions, (3) to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and (4) to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms" (Schneider 2005, 600).

In all cases, regional figures are unweighted averages.

Source: World Bank (2007)

Social Security Coverage (ECLAC 2006 Report)

LATIN AMERICA AND THE CARIBBEAN: SOCIAL SECURITY COVERAGE

(Percentage of employed population paying contributions)

Country	National total	Total-urban areas	Total-rural areas	Urban formal sector ^a	Wage-based urban informal sector ^b	Non-wage urban informal sector ^c	Total men	Total women
Argentina (2002, urban areas) ^d	...	56.0 ^d	...	68.5 ^d	22.7 ^d	...	59.0 ^d	52.5 ^d
Bolivia (2002)	14.5	21.2	4.6	42.8	6.8	10.4	13.8	15.4
Brazil (2001)	47.8	54.3	17.4	78.3	34.4	17.1	48.4	47.0
Chile (2003)	64.9	67.0	48.8	81.6	50.8	20.7	66.6	62.1
Costa Rica (2002)	65.3	68.2	60.5	87.7	43.3	35.0	68.5	59.3
Ecuador (2002, urban areas)	...	32.3	...	57.4	12.8	10.9	32.4	32.0
El Salvador (2001)	32.9	43.4	14.5	78.5	10.9	11.0	30.9	35.9
Guatemala (2002)	17.8	31.1	8.5	63.6	10.0	0.3	18.4	16.7
Mexico (2002) ^d	55.1 ^d	64.8 ^d	30.8 ^d	81.9 ^d	25.5 ^d	...	52.9 ^d	59.1 ^d
Nicaragua (2001)	18.3	25.1	7.6	53.8	7.4	1.3	16.3	21.9
Panama (2002)	53.8	66.6	29.3	88.4	36.5	26.4	48.6	63.4
Paraguay (2000)	13.5	20.2	5.0	48.9	4.1	0.8	13.1	14.2
Peru (2001)	13.0	18.7	2.6	43.8	3.8	3.2	15.0	10.4
Dominican Republic (2002) ^d	44.7 ^d	48.0 ^d	32.7 ^d	52.6 ^d	14.8 ^d	...	43.4 ^d	46.6 ^d
Uruguay (2002, urban areas)	...	63.8	...	88.2	43.9	24.7	63.6	64.0
Venezuela (Bolivarian Republic of) (2002) ^d	61.5 ^d	75.5 ^d	19.9 ^d	...	58.0 ^d	67.1 ^d
Simple average	38.7	45.4	21.9	68.2	21.7	13.5	40.6	41.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

Note: The survey variables used to define the social security contribution vary from one country to another: contribution or affiliation to a pension system (Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Paraguay, Peru and Uruguay), contribution or affiliation to a national social security system (Costa Rica, Ecuador, El Salvador, Guatemala, Nicaragua and Panama), entitlement to “social benefits” (severance/retirement accounts) (Bolivarian Republic of Venezuela) or employment under the terms of a signed contract (Dominican Republic).

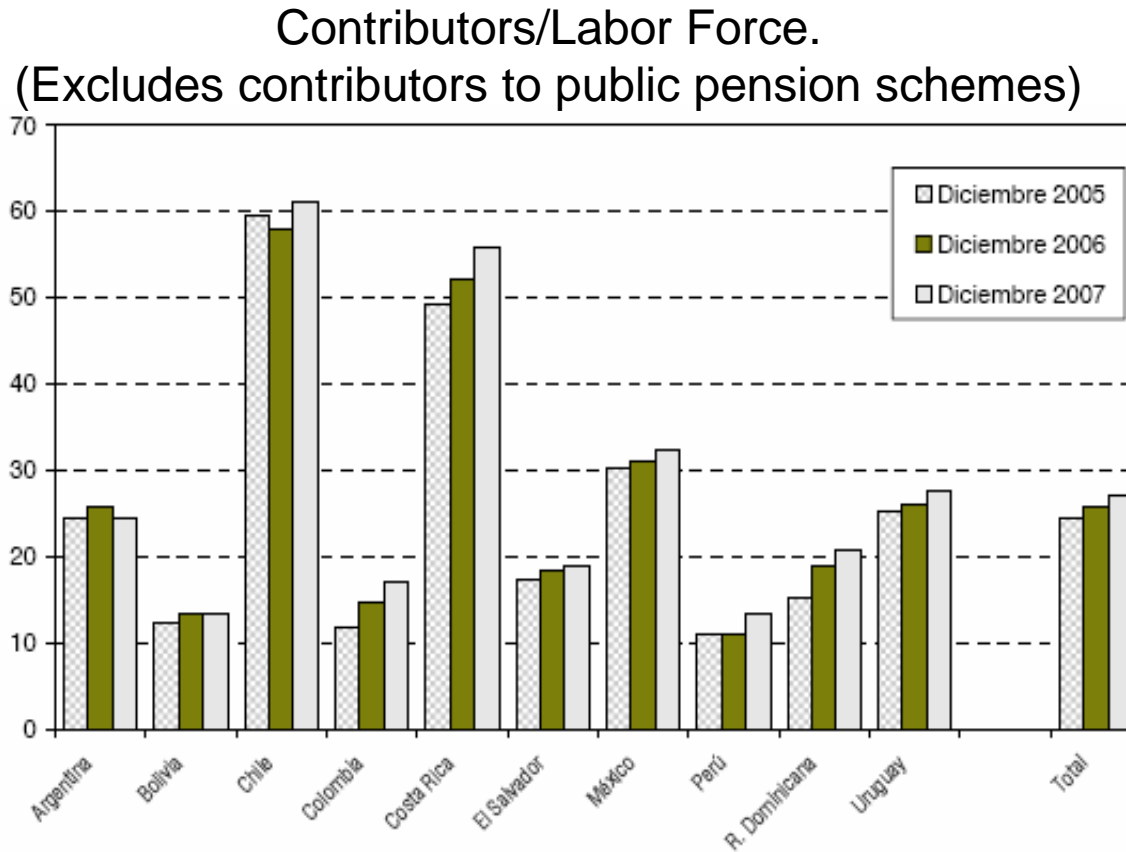
^a Formal sector: Wage earners in the public sector and in firms having more than five employees, professional and technical own-account workers, and owners of firms having five or more employees.

^b Wage-based informal sector: Employees of firms with fewer than five employees and domestic service workers.

^c Non-wage informal sector: Own-account workers who are not professionals or technicians, unpaid family workers and owners of firms with fewer than five employees.

^d Workers' social security contribution rate, excluding own-account workers, unpaid family workers and business owners.

Private Pension System Coverage in Latin America



Source: AIOS Statistical Bulletin. Dec-2007

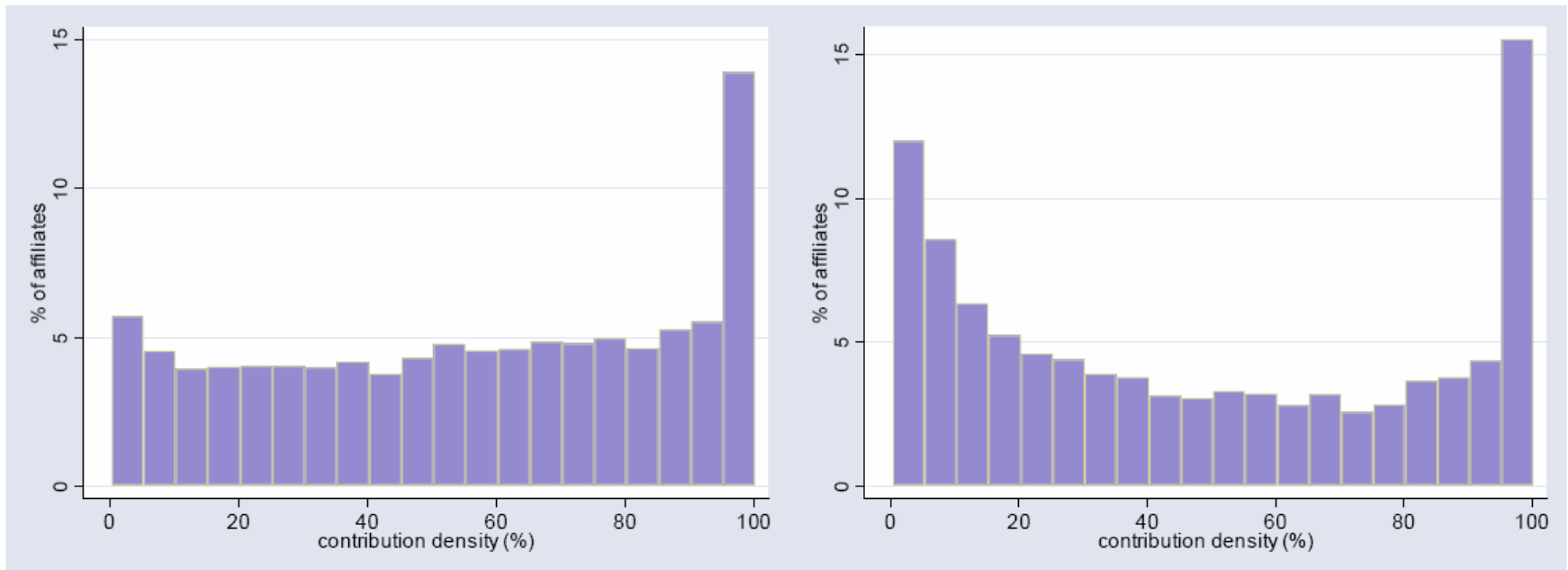
Evidence from Chile

- Availability of Employment History survey and Administrative data enable us to analyze:
 - Density of contributions by gender
 - Distribution of potentially active life by gender
 - Distribution of periods without contributions by gender

Density of contributions by gender

Men

Women



Mean: 56%

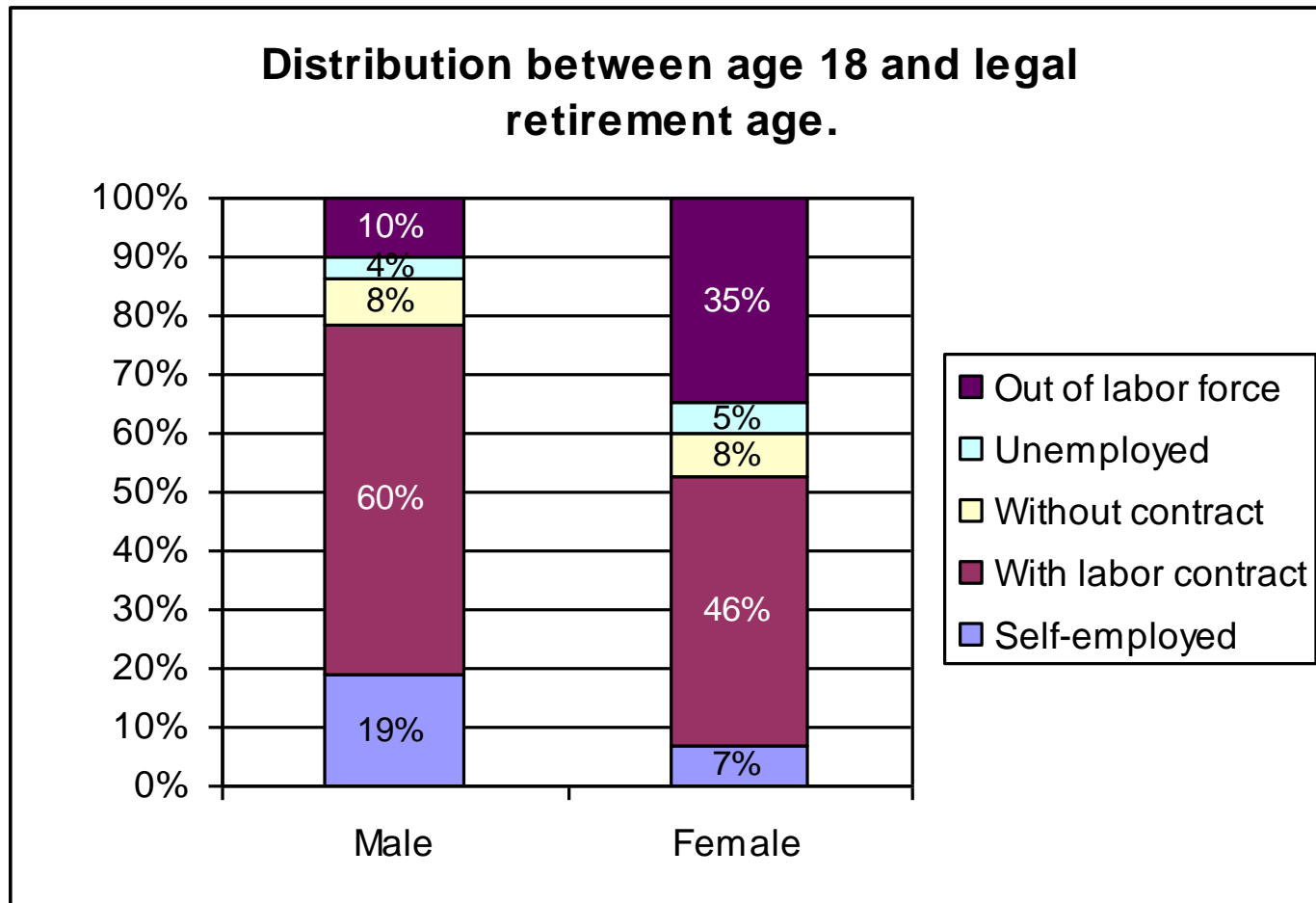
Mean: 48%

Median: 48%

Median: 42%

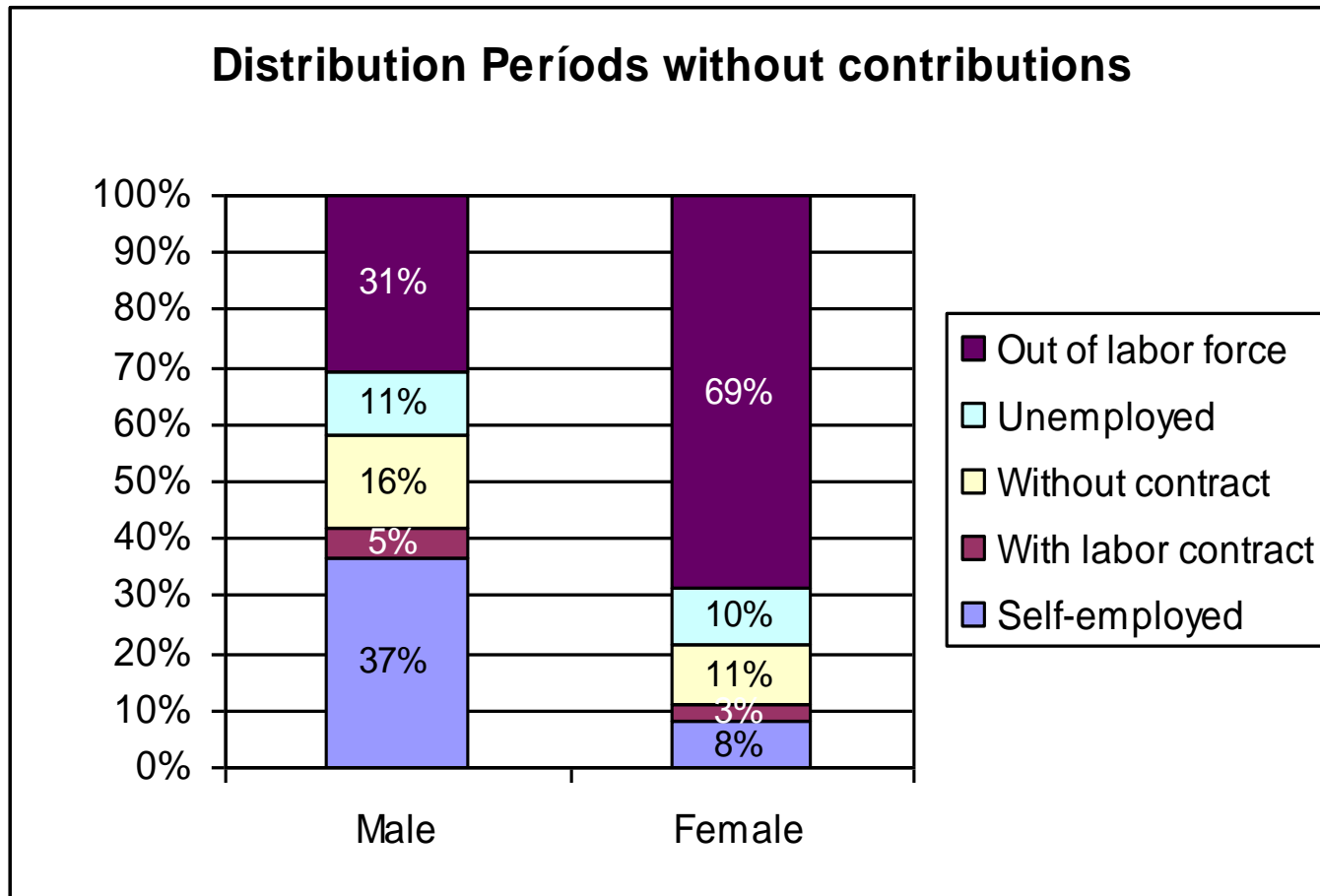
Source: Berstein, Larraín and Pino (2006) using Administrative Data

Distribution of potentially active life by gender



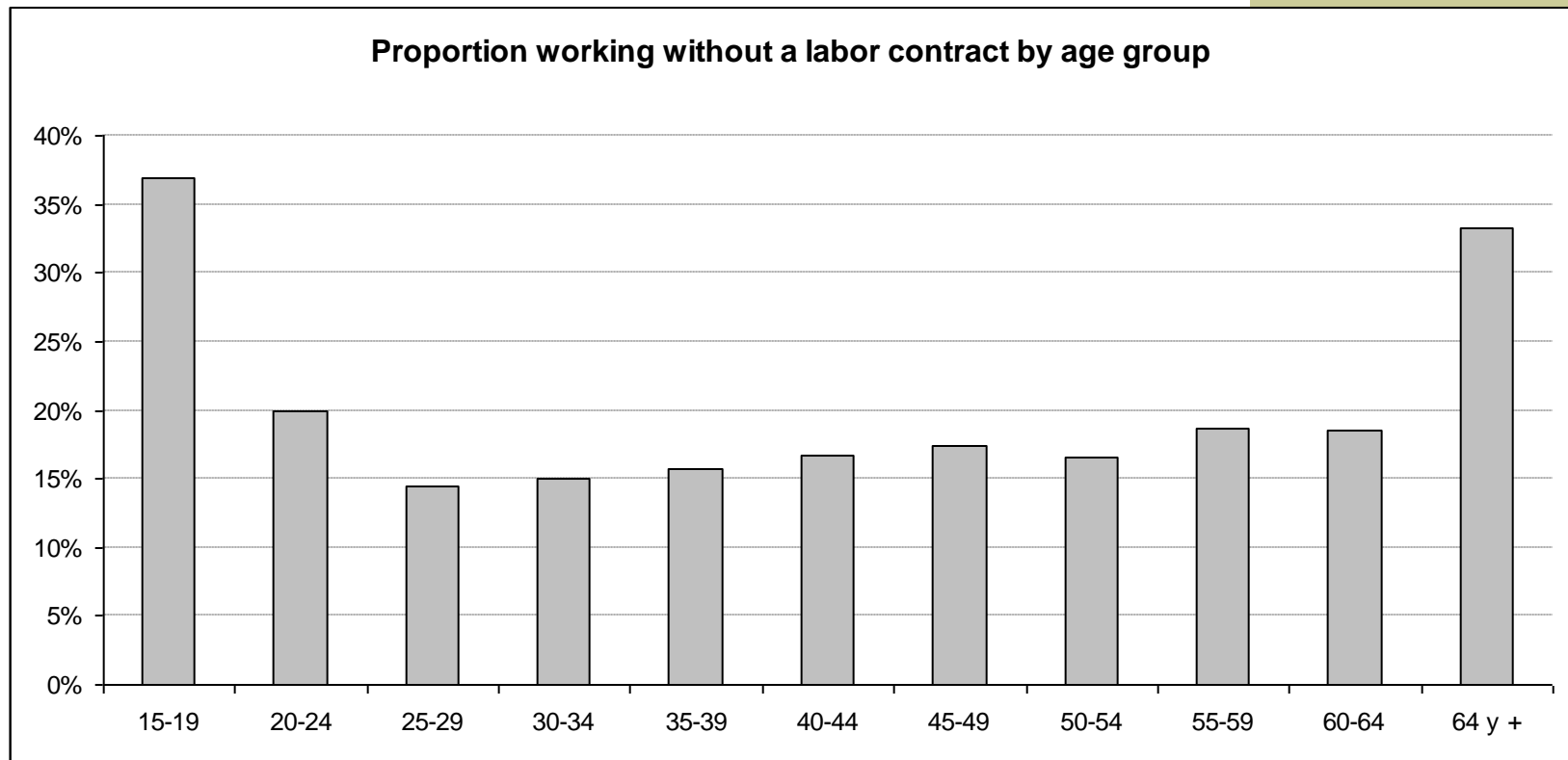
Source: Social Protection Survey – Labor Histories Module

Distribution of periods without contributions by gender



Source: Social Protection Survey – Labor Histories Module

Incidence of informality by age



Considers people working at least 20 hours per week.

Source: National Household Survey (CASN 2006)

Some conclusions:

- The pension system performance depends on the characteristics of the labor market it serves
- Self-employment is more important for men than for women
- There is more space to increase pensions through the contributory system for men than for women.
- Improving female pensions probably requires alternative policies

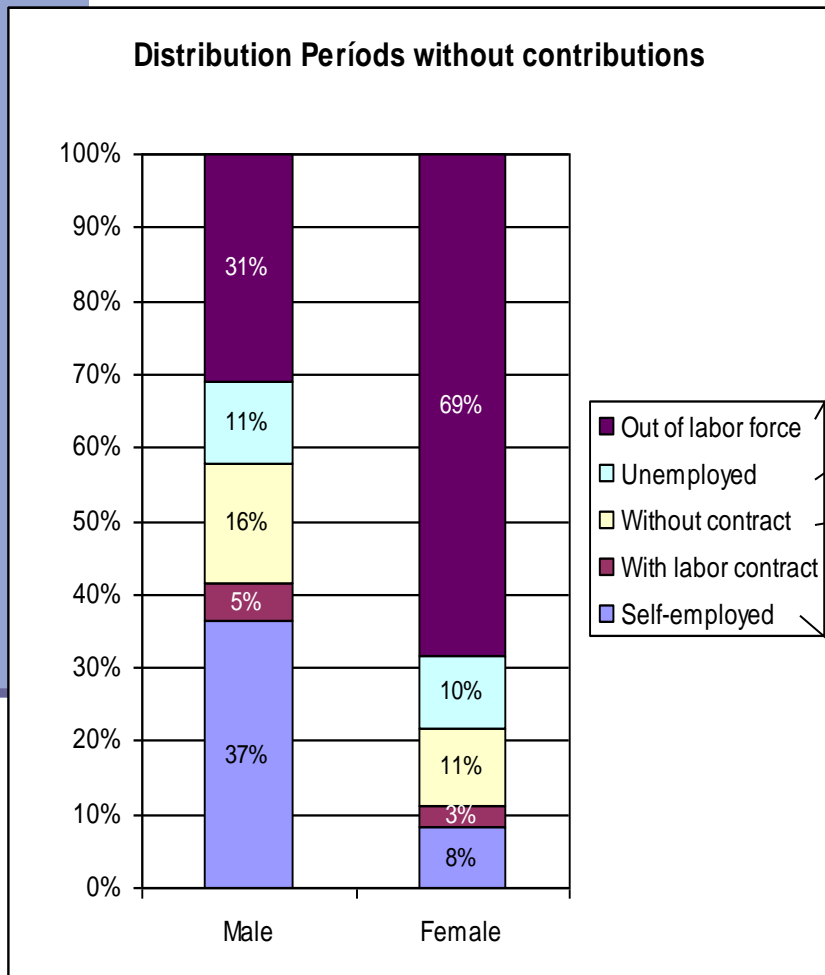
Policy Alternatives to increase Pension Coverage

- Obligation: Effective if observable. Risks further informality
- Subsidies.
- Default options
- Financial Education.
- Non-contributory pensions
- All these alternatives require thorough evaluation of their cost-effectiveness.

Recent Developments to Increase Coverage in Chile

- Strengthening of solidarity pillar.
- Employment Subsidy for young workers
- Mandatization of contributions by self-employed workers.
- Pension Education Fund.
- Further use of Declared and not paid contributions.
- Proposal of subsidy scheme similar to American EITC.

Different instruments tackle different sources of poor coverage



■ Non-contributory pensions (Solidarity Pillar)

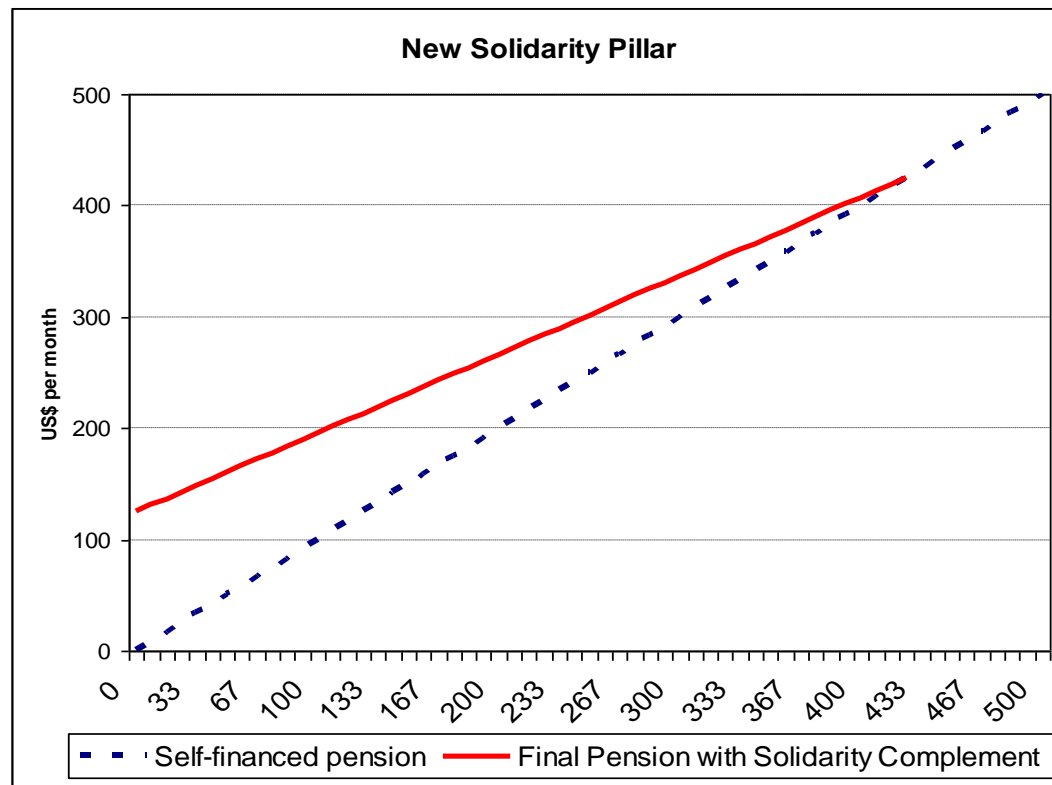
■ Unemployment Insurance

■ Employment Subsidy for Young workers

■ Declared and Not Paid Contributions

■ Mandatory Contributions.

New Solidarity Pillar



Designed to provide coverage to non-members or members with low level of savings

Maintains incentive to participate (pension always increase with savings)

Targeted to 60% of lower income population.

Employment Subsidy for young workers.

- For the first 24 contributions up to age 35.
- Employers receive: Subsidy equivalent to 5% of minimum income.
- Workers receive: Subsidy of same amount paid directly into individual account.
- Worker's income should be lower than 1.5 times the minimum income.
- Gives incentive to formalization and reinforces early contributions

Mandatory Contributions for self-employed workers

- Rationale given by new solidarity pillar: subsidy inversely related to self-financed pension
- Feasibility given by annual income tax declaration process.
- Gradual implementation:
 - 2008-2010: Education process
 - 2011-2013: Default option with increasing income base
 - 2014-2016: Mandated pension contributions
 - 2017: Mandated pension+health contributions

Recent Developments in Other Latin American Countries

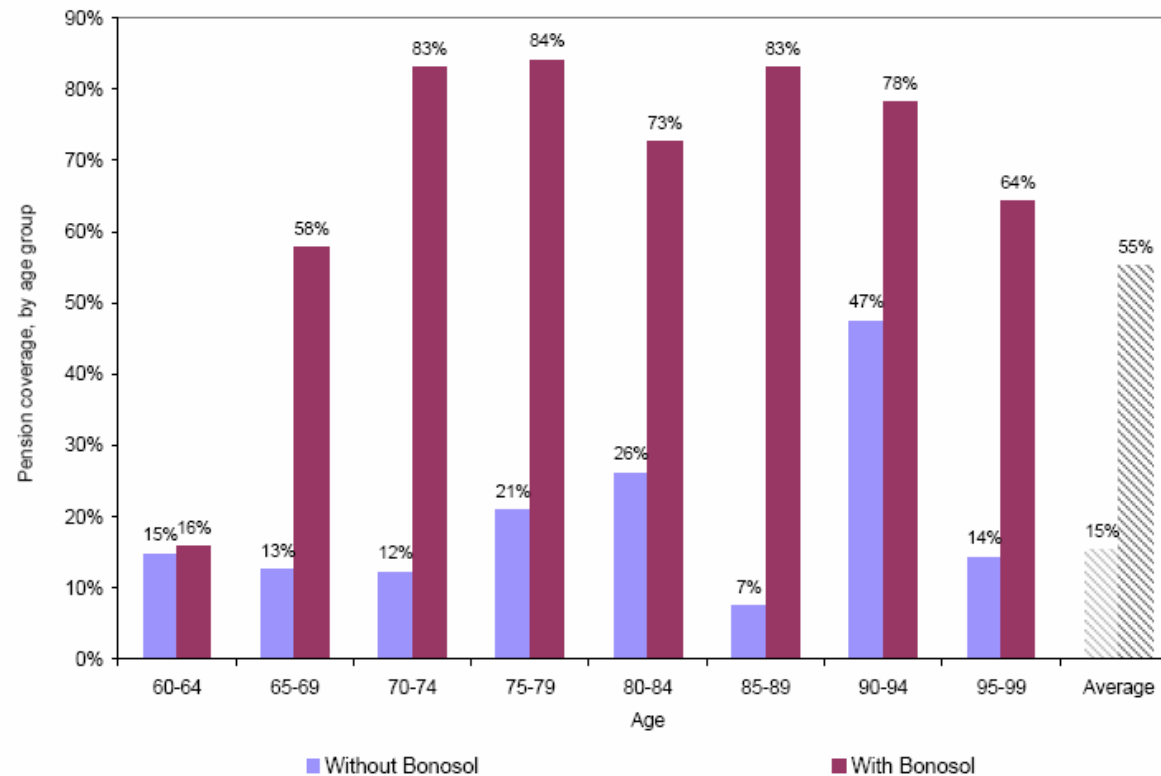
- In general coverage of the informal sector is tackled through non-contributory benefits:
 - BONOSOL in Bolivia
 - Rural Pensions in Brazil
- Contribution Subsidies:
 - Cuota Social in Mexico.
 - Pension Solidarity Fund in Colombia.
- Recent small establishments law enacted in Peru:
 - Establishes social pension system based on individual accounts and a social fund
 - Reduced individual contributions
 - State-financed matching contributions
 - Only small firms are eligible.

Bolivia: BONOSOL

- Universal Pension for individuals aged 65 and older.

IMPACT OF BONOSOL ON PENSION COVERAGE IN BOLIVIA, 2002

(Percentage of individuals receiving income from retirement or other pensions, with or without Bonosol)



Source: ECLAC (2007)

Brasil: Rural Pensions

- Benefits for old-age, disability, survivorship and work-related accidents.
- Old-age starting at 60 for men and 55 for women.
- 2.2% contribution rate calculated over the selling price of agricultural products.
- Workers need to register the amount of time working in rural sector.
- Minimum amount of time is required to obtain benefits

Contribution Subsidies

- Mexico: Cuota Social.
 - Fixed amount contribution made by the state.
 - Deposited in individual account
 - Proportional to the number of days contributed by the individual.
- Colombia: Pension Solidarity Fund
 - State and higher income individuals contribute to solidarity fund
 - Low income workers contributions are subsidized

Further challenges

- Financial Education is a major challenge in a mandatory system based on individual capitalization.
- Recent Chilean Pension Reform includes a Pension Education Fund to finance initiatives that raise awareness on the importance of pension savings
- Impact evaluation of these initiatives will be a crucial part of the implementation of reform
- Recent evidence show important effect of improving expected pension information on voluntary savings (Fajnzylber, Plaza and Reyes (2008))

Conclusions

- Best policies to increase coverage depend on characteristics of specific labor market
- Nature of informality may differ from one country to another.
- Multiple strategies may be needed to tackle different dimensions of informality:
 - Non-contributory or complementary benefits
 - Employment subsidies
 - Contribution subsidies.
 - Mandates or default options.
 - Special regimes
- Improving financial education is crucial if at least some component of the pension system is DC and based on pension funds.

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