

Addressing the coverage gap – schemes for informal sector workers

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The 'coverage gap'

- Almost all countries mandate pension coverage for formal sector workers
- But after operating for decades, coverage of these schemes has remained stagnant and for the poorest, it may not make sense (James (1999)).
- There is little evidence that coverage is significantly affected by type of scheme or whether it is funded or not
- There is, however, a strong correlation to income per capita which is a proxy for many factors

What are the policy options?

- Find ways to expand existing contributory schemes
 - Statutory mandate can be expanded
 - Better enforcement
 - Improve schemes in terms of the 'deal' or rate of return to contributors
 - Reduce administrative costs
 - Reduce non-pension incentives to be in the informal sector
- Set up parallel schemes designed specifically to increase voluntary participation by informal sector workers
- Introduce or expand non-contributory or 'social pensions'

Contributory schemes for informal sector workers

- Standard DB plans do not work here
- Transaction costs are high relative to incomes of workers
- Two approaches observed:
 - 'pseudo' DB
 - subsidized DC

Contributory schemes for informal sector workers

- International experience is very thin
- Pseudo DBs based on flat payment in flat payment out or proxy wages (examples include Sri Lanka and Tunisia)
- Subsidized DCs involve a matching contribution from government (examples include planned matching scheme in Mexico, operating scheme in West Bengal in India)

Contributory schemes for informal sector workers

- Pseudo DBs: pros and cons
 - allows worker to avoid investment risk
 - Difficult to set up such without creating an unfunded liability, especially with flat payment schedules
 - Proxy wages difficult to assess with accuracy
 - Vesting issues for those with inconsistent contributions
 - Lack of portability
- Subsidized DCs: pros and cons
 - Imposes some investment risk on worker
 - Costs are up front and could be high depending on matching contribution and take up rate
 - Sustainable by definition
 - Portable in principle

Contributory schemes for informal sector workers

Country	Scheme type	Other insurance	Status
Dominican Republic	Subsidized DC	life and disability	Law passed but not implemented
India (West Bengal)	Subsidized DC	none	Implemented; 650,000 members in 2005
India (Kerala)	Mixed DB and DC	various	Implemented
Indonesia	Mixed DB and DC	work injury, health, life	Law passed but not implemented
Mexico	Subsidized DC	unclear	Law passed but not implemented
Sri Lanka	Pseudo DB	life and disability	Implemented; 650,000 members in 2005
Thailand	Undecided	unclear	Law under consideration
Tunisia	Pseudo DB	life and disability, others	Implemented
Turkey	Pseudo DB	life and disability	Implemented
Vietnam	Subsidized DC	none	Draft law under consideration

Contributory schemes for informal sector workers

- Rethink allocation of fiscal incentives for voluntary pension take up
 - Standard tax deduction or tax credit approach does not reach the informal sector, can be regressive and there is little evidence of positive savings impact
- Matching conts are found in China and India among others and are planned in Chile and South Africa
- More evidence is needed as to the elasticity of contributions to the size of the match (e.g., Duflo et. al. (2004)) as well as other design features (withdrawal conditions, transaction costs, impact of intermediaries etc.)
- Portability with formal sector schemes a big plus

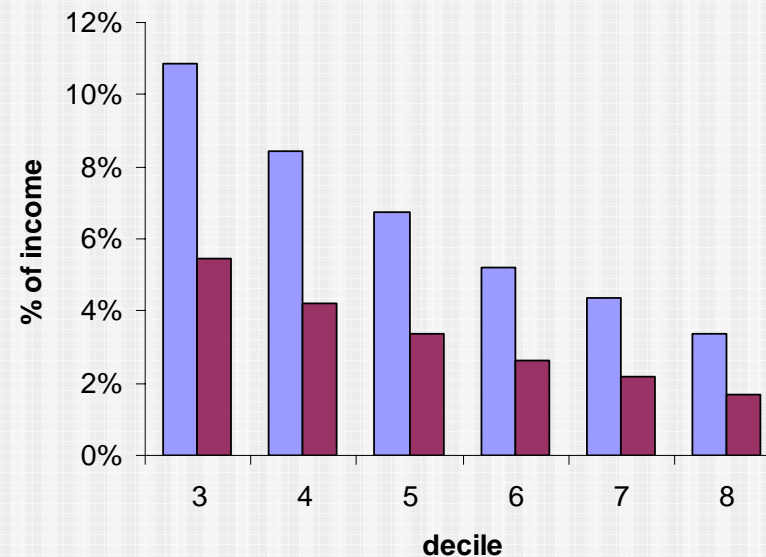
Targeting within the informal sector

- Informal sector is majority of labor force in almost all lower income countries, but in many (especially larger countries) it is a heterogeneous population in terms of key variables related to coverage:
 - Ability and willingness to pay
 - Access to formal institutions, branches
 - Membership in groups (co-ops, MFIs, etc.)
 - Occupation, seasonality of income etc.
- Expansion of coverage through effective fiscal incentives could start with 'low hanging fruit'
- Informal sector then must be analyzed and disaggregated accordingly
- Achieving critical mass and credibility can set the stage for further expansion to more difficult population groups

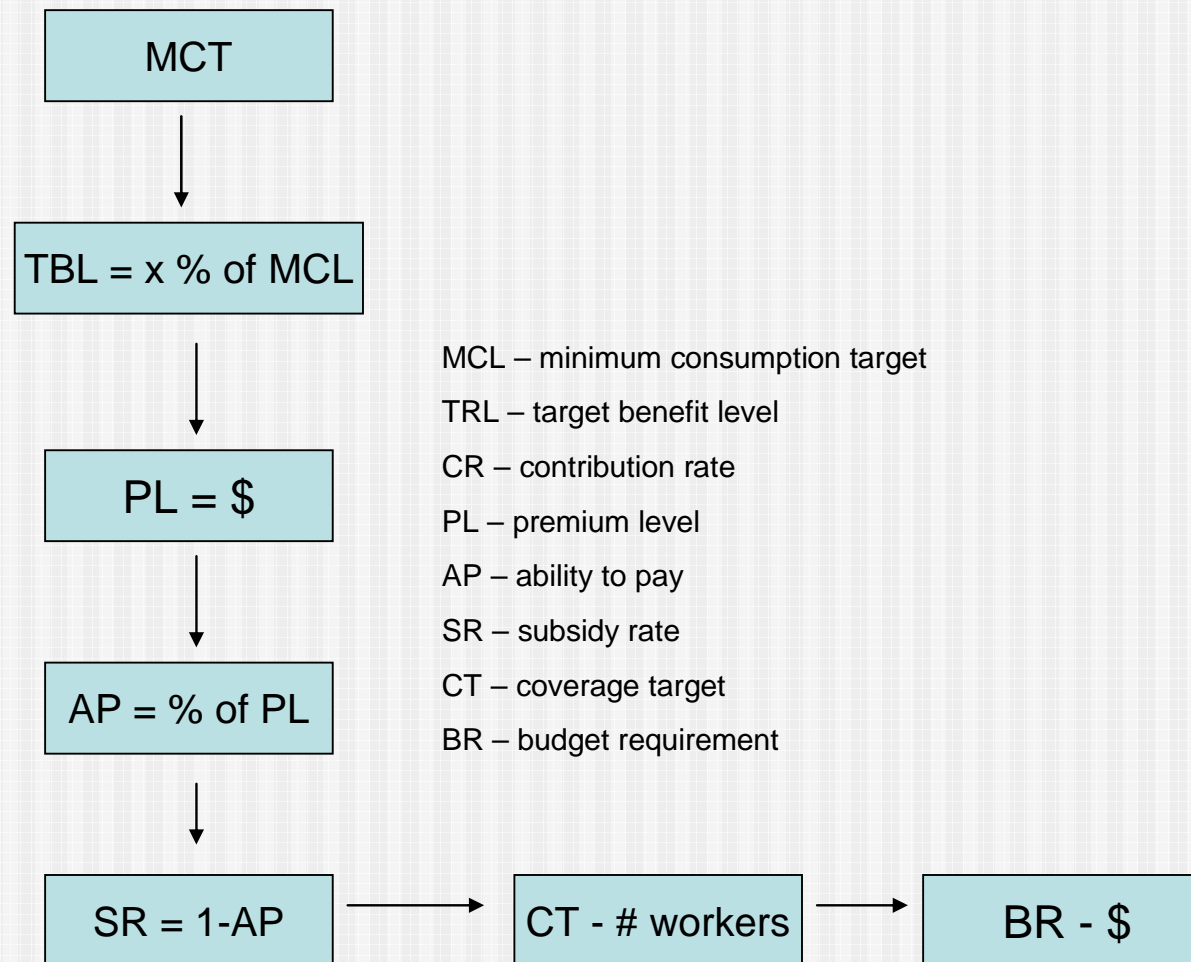
Targeting within the informal sector

- Example case study: India
- Informal sector is over 90 per cent of labor force covering vast distances and a wide range of circumstances
- From small base, the proportion linked to some type of group (SHG, MFI, co-op, etc.) is increasing rapidly

Capacity to pay varies widely among informal sector workers



Steps in designing scheme



Summary

- Coverage is a function of non-pension variables correlated with income levels
- Low income country coverage rates are below 20 per cent
- Schemes for informal sector workers are one of the three ways to approach the coverage gap; design must respect certain realities:
 - Voluntary by definition; incentives required.
 - Transaction costs must be kept very low
 - No reference wage is available
 - Flexibility as to contribution schedules required

Summary

- This suggests considering the following:
 - Defined contribution approach
 - Shift from tax deduction to direct matching contributions
 - Reliance on existing groups/intermediaries like MFIs, coops, to reduce costs – ‘micropensions’
 - Analysis of informal sector to segment into different parts by age, income, geography, group membership and other factors that could affect take up
 - Piggybacking on other programs for working age poor to reduce admin costs and establish targeting
 - Experimentation to maximize coverage for a given fiscal envelope – what is the ‘right’ match

Thank you