



## Social Protection for All: How to Cover Middle-Sector Workers with Informal Jobs

by Ángel Melguizo

- ◆ Informality remains pervasive in Latin American and Caribbean labour markets.
- ◆ Many “middle-sectors workers” (around the middle of the income distribution) are employed informally and contribute irregularly to a public or private pension.
- ◆ Governments should consider extending social pensions and stimulating (even financially, via defined matching contributions) individual savings.

Coverage of social-protection schemes in Latin America remains low despite the reforms introduced since the 1990s. Many countries in the region implemented private mandatory individual pension accounts, with the aim of attaining financial sustainability and strengthening incentives to participate. Nonetheless, the percentage of workers contributing actively to pension systems remains well below 50%, similar to traditional systems. Health-care reforms aimed at universalising access, separating access from payment of contributions. However, a two-tier system emerged in which the non-contributory level is characterised by low-quality treatment and lack of resources. Finally, unemployment insurance is very weak.

### Labour informality is pervasive in Latin America

The dual structure of labour markets in Latin America and the Caribbean plays a part in explaining this limited coverage. Informality remains high, ranging from around three-quarters of employment in Ecuador and Peru, to one-third in Colombia and Chile. Its interaction with contributory social-protection systems creates a vicious cycle: the majority of informal workers contribute irregularly, if at all, thereby weakening the systems which then provide insufficient support to workers when they need it.

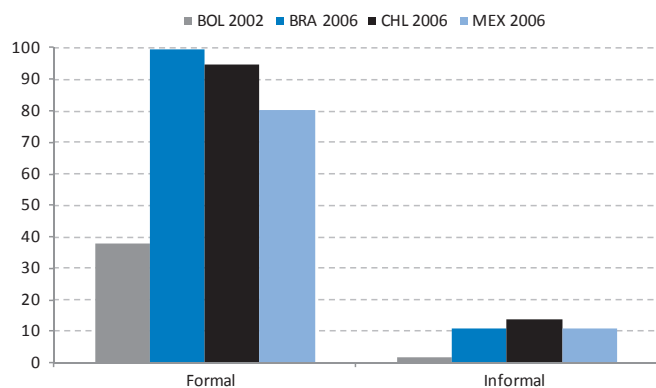
Focusing on pensions, most formal workers (i.e. those workers with a signed contract) contribute adequately; from around 75% in Mexico in 2006, to 95% in Chile and 99% in Brazil

– well above the 40% who contributed in Bolivia in 2002. By contrast, in the case of informal workers, contributions are extremely limited, below 15% in Brazil, Chile and Mexico and almost negligible in Bolivia. Moreover, coverage is more clearly linked to income levels than in the case of formal workers. Without reforms, poverty in old age is therefore likely to exacerbate inequalities observed among the working-age population.

### Middle-sector workers tend to be informal and contribute rarely to their pension schemes

The informal sector is not composed only of disadvantaged workers; labour informality is also a middle-sector issue. Indeed, the number of middle-sector informal workers in Latin America is high. Focusing on four countries alone – Bolivia, Brazil, Chile and Mexico – 44 million middle-sector workers are employed informally, a large share of the total 72 million middle-sector workers in those countries. Actually, there are more informal than formal workers among the middle sectors in all of these countries except Chile. Not surprisingly, social protection systems fail to reach even half of middle-sector workers, leaving them without adequate employment protection and access to social safety nets. This situation represents a pressing challenge for public policy, since low levels of affiliation and irregular contribution histories put people at a high risk of significant downward social mobility when they get sick, lose their job or retire.

## Middle-sector workers' pension coverage rate in Latin America



Note: Percentage of affiliates (Bolivia and Mexico) or contributors (Brazil and Chile), over middle-sector workers (14-64 years). Formal workers are those subject to a written contract or a *carteira de trabalho* in Brazil.

Source: Based on National Household Surveys.

### Pension policies to cover the uncovered

Three key features of Latin America's socio-economic situation must be taken into account when designing a pragmatic reform: high levels of labour informality, a young (although rapidly ageing) population and limited fiscal resources. Social insurance for many people will have to be provided by means other than via formal employment. In fact, such policies must encourage participation in contributory systems by the informal middle sector – people who are both able to save and likely to desire social-protection coverage. They may help to mobilise the savings for social insurance and build a fairer and more efficient social risk-management system.

*Ex post* policies (targeted at people after they retire) include spreading social pensions not linked to individuals' history of contributions to the system, as implemented in Bolivia and Chile; such schemes are expensive (from 1% of GDP each year) but effective against poverty. Within the scope of mandatory contributory pensions systems, policy makers should also evaluate reducing the number of years of necessary contributions to qualify for a minimum pension in order to keep the promise of covering informal middle-sector workers with irregular contribution records.

*Ex ante* policies (targeted at people during their working life) seem likely to have the greatest scope for pension reforms that benefit the middle sectors: from compulsory affiliation for the self-employed (especially for the more educated segments) to a range of hybrid approaches for workers in the lower reaches of the middle sectors who may not be able to afford to contribute (e.g. "semi-compulsory" affiliation), in which workers are automatically enrolled, but are able to opt out. Greater flexibility regarding contributions, with respect to both amounts and timing (even permitting withdrawals in limited circumstances such as long-term unemployment or health problems) are other policy tools that can benefit workers in the lower middle sector. Reforms to address the concerns of upper middle-sector workers should focus on the so-called "matching defined contributions": transfers made by the state into an individual's defined contribution pension plan, conditional on their own voluntary contributions, as introduced in Colombia, Mexico and Peru.

### Further reading

Costa, R. Da, J.R. de Laiglesia, E. Martinez and A. Melguizo (2010), "The Economy of the Possible: Pensions and Informality in Latin America", *Working Paper*, OECD Development Centre, Paris, forthcoming.

Jütting, J.P. and J.R. de Laiglesia (eds.) (2009), *Is Informal Normal? Towards More and Better Jobs in Developing Countries*, OECD Development Centre, Paris.

OECD (2010), *Latin American Economic Outlook 2011: How Middle-class is Latin America?* OECD Development Centre, Paris.