

SOCIAL PROTECTION AND THE INFORMAL SECTOR

CHALLENGES, OBSTACLES AND POSSIBILITIES

ASEAN SOCIAL SECURITY ASSOCIATION (ASSA)
14th Board Meeting, August 19-22, 2004, Jogjakarta, Indonesia
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TOPICS

- **Why social protection is needed for informal sector?**
- **The role of informal sector/informal economy**
- **How to extend social protection to informal sector**
- **Some case studies of successful interventions**
- **Discussion and Conclusion**

'History teaches nothing, but only punishes for not learning its lessons.'

A quote from a Russian medievalist
(from Robert Heilbroner, the economic
historian, in his "21st Century Capitalism")

Why ADB is concerned in social protection for informal sector

- Fighting poverty is ADB's overarching goal
- Social Protection is one component in the second pillar (social development) of ADB's Poverty Reduction Strategy (1999)
- Most of the poor are outside the formal sector; 70-90% of the workforce in Asian developing countries is in the informal sector

Informal Sector vis-à-vis Informal Economy

- Is informal sector a “sector”?
- What are the characteristics of people working in the informal sector?
- Does informal sector exist both in rural and in urban areas? What are their differences?
- Should we talk about informal economy?

Characteristics of Informal Sector by ILO (Kenya mission of 1972)

- (a) ease of entry;
- (b) reliance on indigenous resources;
- (c) family ownership of enterprises;
- (d) small scale of operation;
- (e) labor-intensive and adapted technology;
- (f) skilled acquired outside the formal school system; and
- (g) unregulated and competitive markets.

Concept of Informal Sector (World Bank)

The two types of informal sector activities can be described as follows:

1. Coping strategies (survival activities):

casual jobs, temporary jobs, unpaid jobs, subsistence agriculture, multiple job holding;

2. Unofficial earning strategies (illegality in business):

2.1. Unofficial business activities: tax evasion, avoidance of labor regulation and other government or institutional regulations, no registration of the company;

2.2. Underground activities: crime, corruption – activities not registered by statistical offices.

Average Size of the Informal Economy for Developing, Transition and OECD-Countries in Terms of Value-Added and of the Labor Force over two periods (1999/2000)

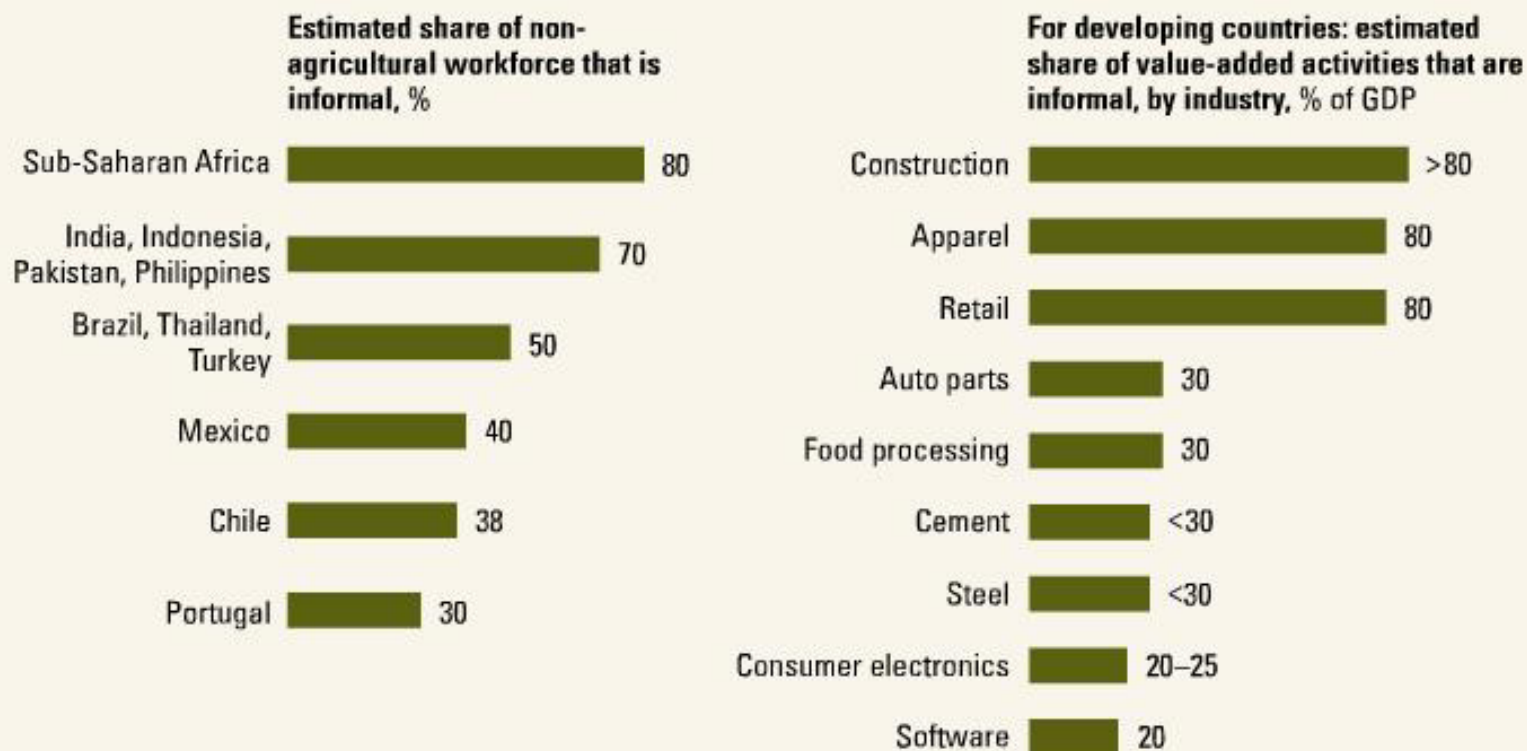
Countries	Average Size of the Informal Economy – Value added in % of official GDP 1999/2000	Average Size of the Informal Economy Labor Force in % of official Labor Force 1999/2000
	<i>Currency Demand and DYMIMIC method (Number of Countries)</i>	<i>Survey and Discrepancy Methods (Number of Countries)</i>
Developing countries:		
Africa	42 <i>(23)</i>	48.2 <i>(23)</i>
Central and South America	41 <i>(18)</i>	45.1 <i>(18)</i>
Asia ¹⁾	29 <i>(26)</i>	33.4 <i>(26)</i>
Transition countries	35 <i>(23)</i>	-
Western OECD Countries - Europe	18 <i>(16)</i>	16.4 <i>(7)</i>
North American and Pacific OECD Countries	13.5 <i>(4)</i>	-

1) Here not all countries are developing countries like Japan, Singapore or Hongkong.

Source: Own calculations.

The extent of informality concerning the workforce, and economic sectors

Shades of gray



Source: International Labour Organization; World Bank; McKinsey analysis

Importance of the Informal Economy

“Informality is among the most seriously misunderstood of all economic issues. Informal companies evade fiscal and regulatory obligations, including value-added taxes, income taxes, labor market obligations (such as social-security taxes and minimum-wage requirements), and product market regulations (including quality standards, copyrights, and intellectual-property laws). ”

By Ms. Farrell, McKinsey

Importance of the Informal Economy (cont.)

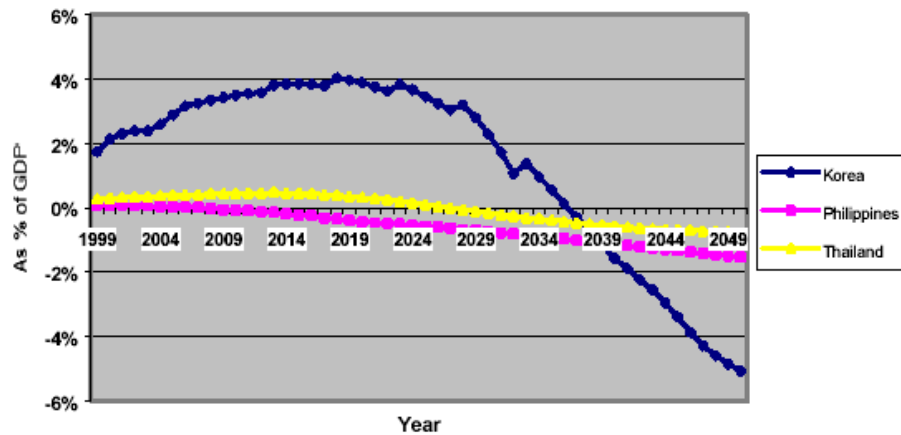
- Most people live and work in the informal sector in developing countries.
- A single definition does not fit to informal economy; it is complex and full of diversity
- The perception that informal sector/economy will disappear over time along with economic development, may not be true in short term
- Governments should pay more attention to the role of informal sector

How to extend social protection to the informal sector?

“In many developing countries, not more than 10 per cent of the working population is covered by formal sector social security schemes, and it is therefore important to examine what social security options are open to informal sector workers.” (the ILO)

- Conventional social security schemes used in the formal sector, are difficult to apply directly to the informal sector.
- Before even trying to expand these schemes to informal sector, governments and agencies should reform, revise and improve these schemes.

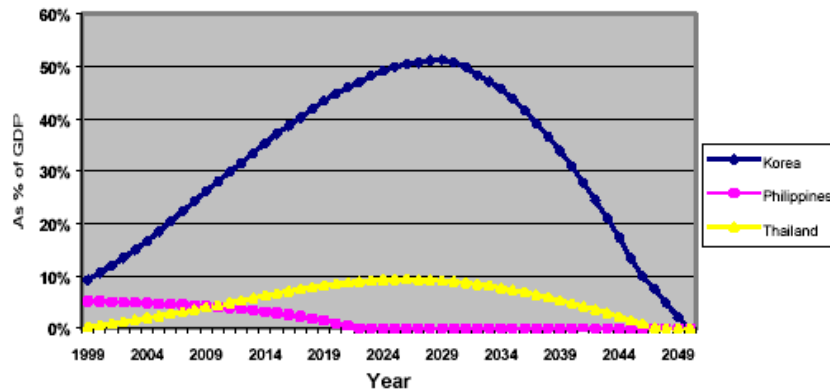
Figure II.5 Current Balance of Pension Fund, Selected Countries



Source: PROST calculations, The World Bank

Some figures of pension funds

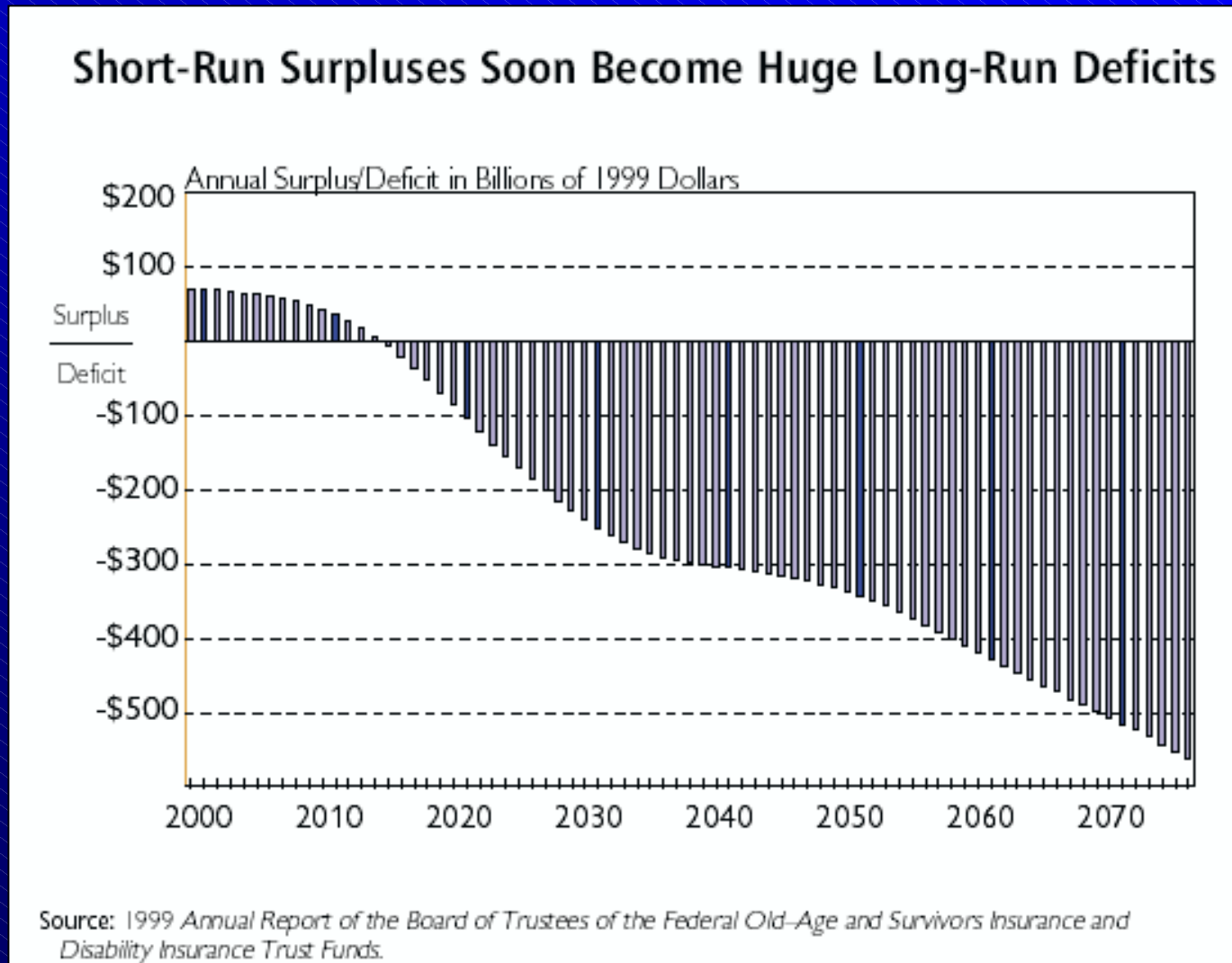
Figure II.6 Pension Fund Reserve, Selected Countries



Source: PROST calculations, The World Bank

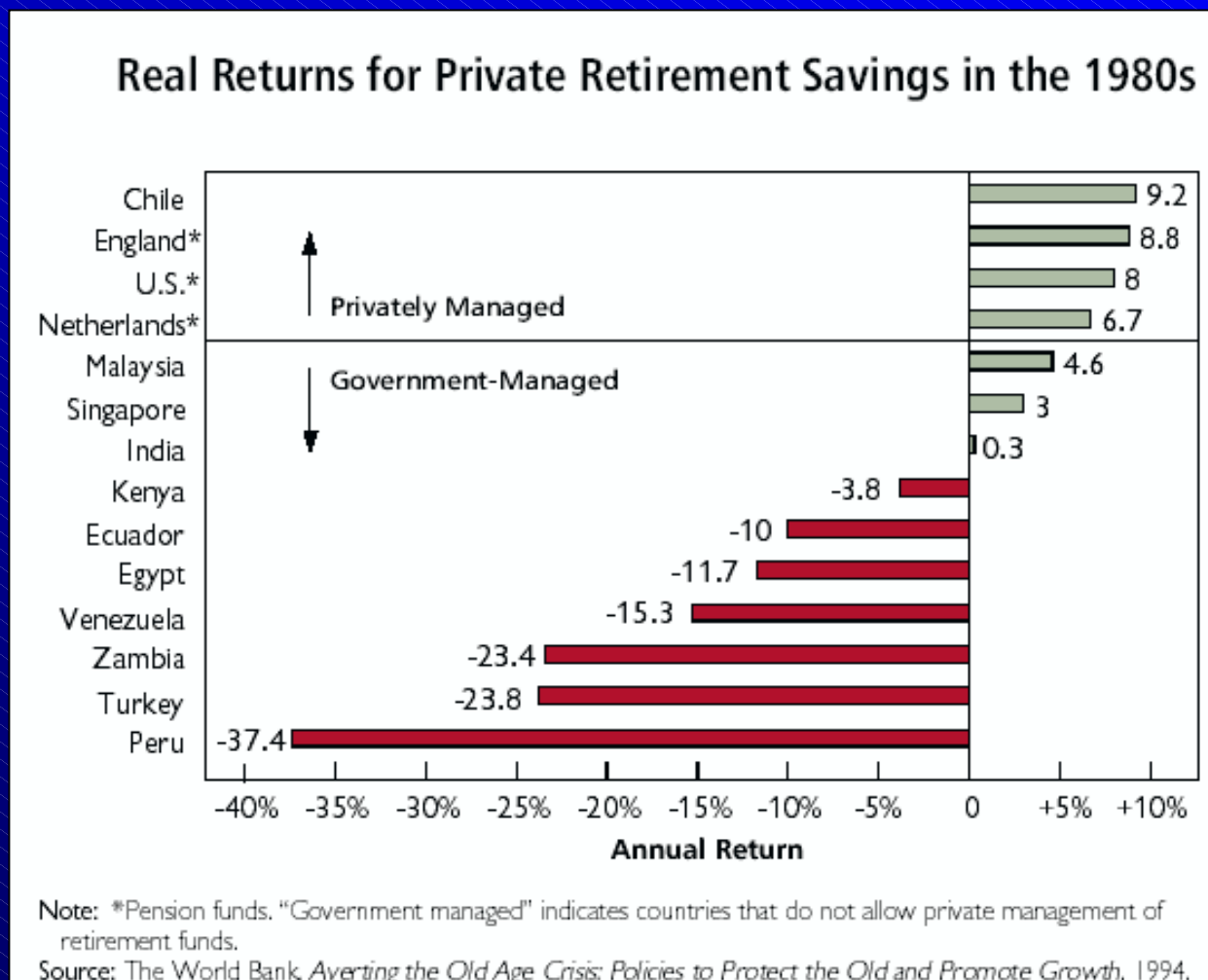
Some figures of pension funds

Annual Surplus/Deficit of the US Social Security Trust Funds

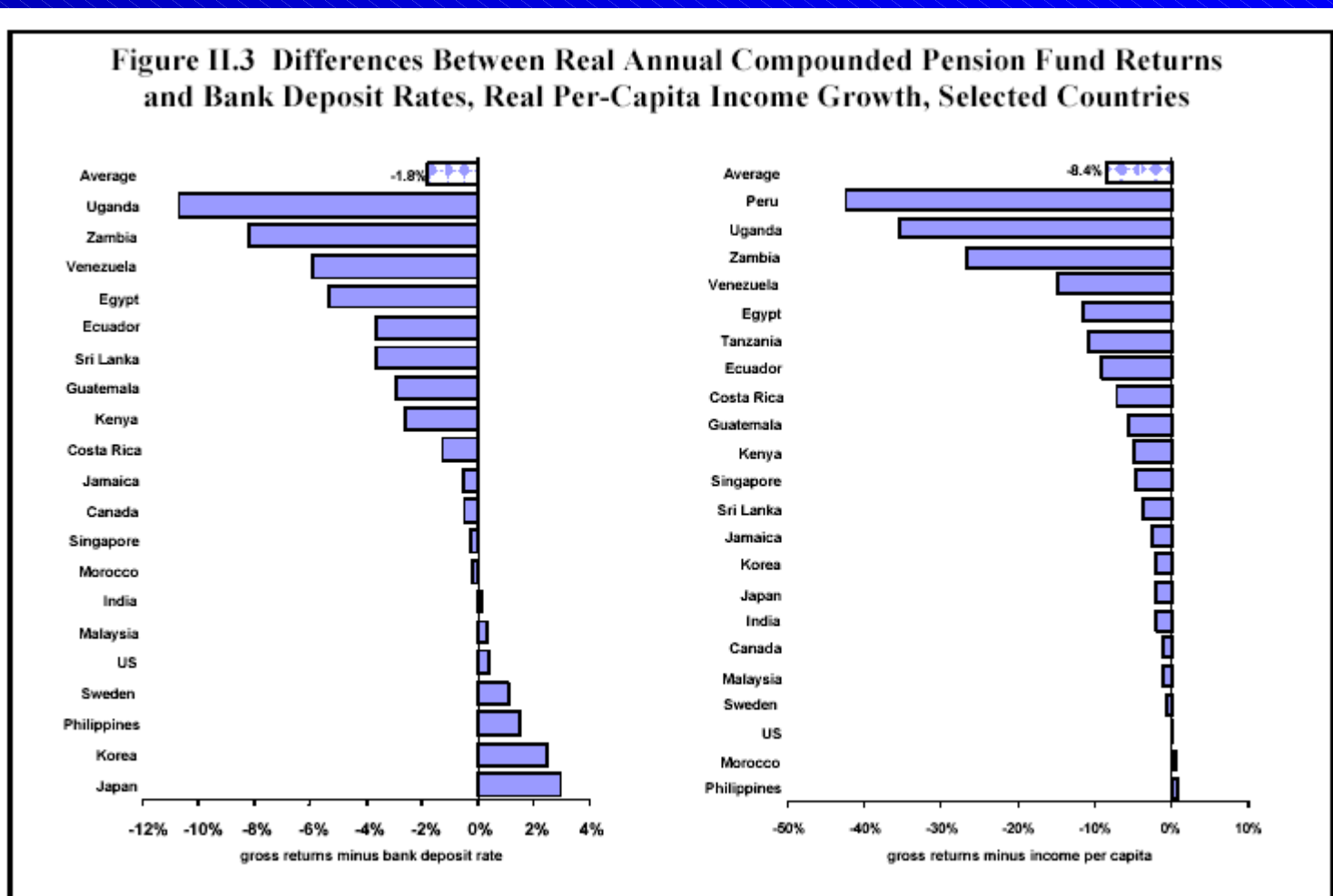


Some figures of pension funds

Real returns for private retirement savings from some developed and developing countries



Some figures of pension funds



Source: Iglesias and Palacios, 2000. See source for calculations and time periods used for countries.

What do the poor want?

- The poor, as well as all people, want to satisfy first their basic needs for food, shelter, security, health and family.
- The assumption has been that these basic needs could be met by education and employment.
- Since life includes risks and vulnerabilities, like unemployment, sicknesses and old age, people try to prepare themselves to meet these contingencies.
- Historically people looked to their families, clans, tribes, communities, religious groups and authorities - lords, chiefs and kings - to meet their needs for social security. This arrangement is gradually fading.

Obstacles for social insurances

- Many segments of the informal sector are incapable of being covered by any contributory pension scheme.
- Beside the lack of trust in public institutions, the low-income workers have the legitimate aversion for irrevocable and long-term savings.
- **The main obstacle is that saving for pensions is not genuinely beneficial for people in the informal sector;** even well managed pension schemes just cannot produce investment yields high enough to compete with the returns that poor workers get when they invest in new equipment and tools, better housing, land or their children's education.

Possibilities for extension

- World Bank “Social Risk Management”
- ADB “Social Protection Strategy (2001)” with five implementation areas
- A broader definitions of social protection, for example, a triple categorization of the SP

World Bank “Social Risk Management”

- The concept of social risk management asserts that individuals, households, and communities are exposed to multiple risks from different sources, both **natural** (such as earthquakes, floods, and illness) and **manmade** (such as unemployment, environmental degradation, and war).
- Poor people are typically more exposed to risk and have less access to effective risk management instruments than people with greater assets and endowments.

ADB "Social Protection Strategy (2001)"

- Social protection, as defined in the SPS, is a "set of policies and programs designed to reduce poverty and vulnerability by promoting efficient labor markets, diminishing people's exposure to risks, and enhancing their capacity to protect themselves against hazards and interruption/loss of income."
- ADB's social protection strategy is composed of five major components: (i) labor markets, (ii) social insurance, (iii) social assistance, (iv) micro and area-based schemes to protect communities, and (v) child protection.

A broader definitions of social protection, for example, a triple categorization

The SP priorities (Ghai, D. 2003)

1. The first priority is to ensure adequate nutrition, basic health care, primary education, clean water, decent sanitation and shelter for all.
2. The second category of needs relates to contingencies such as sickness, accident, death of the principal breadwinner, disability and old age, as well as assistance to vulnerable groups such as abandoned children and widows.
3. The third task is disaster relief for the victims of floods, droughts and earthquakes that destroy property, livelihood and sources of support. Despite the increasing frequency of such calamities, very little attention has been given to ways and means of compensating people for loss of property and ensuring their livelihood.

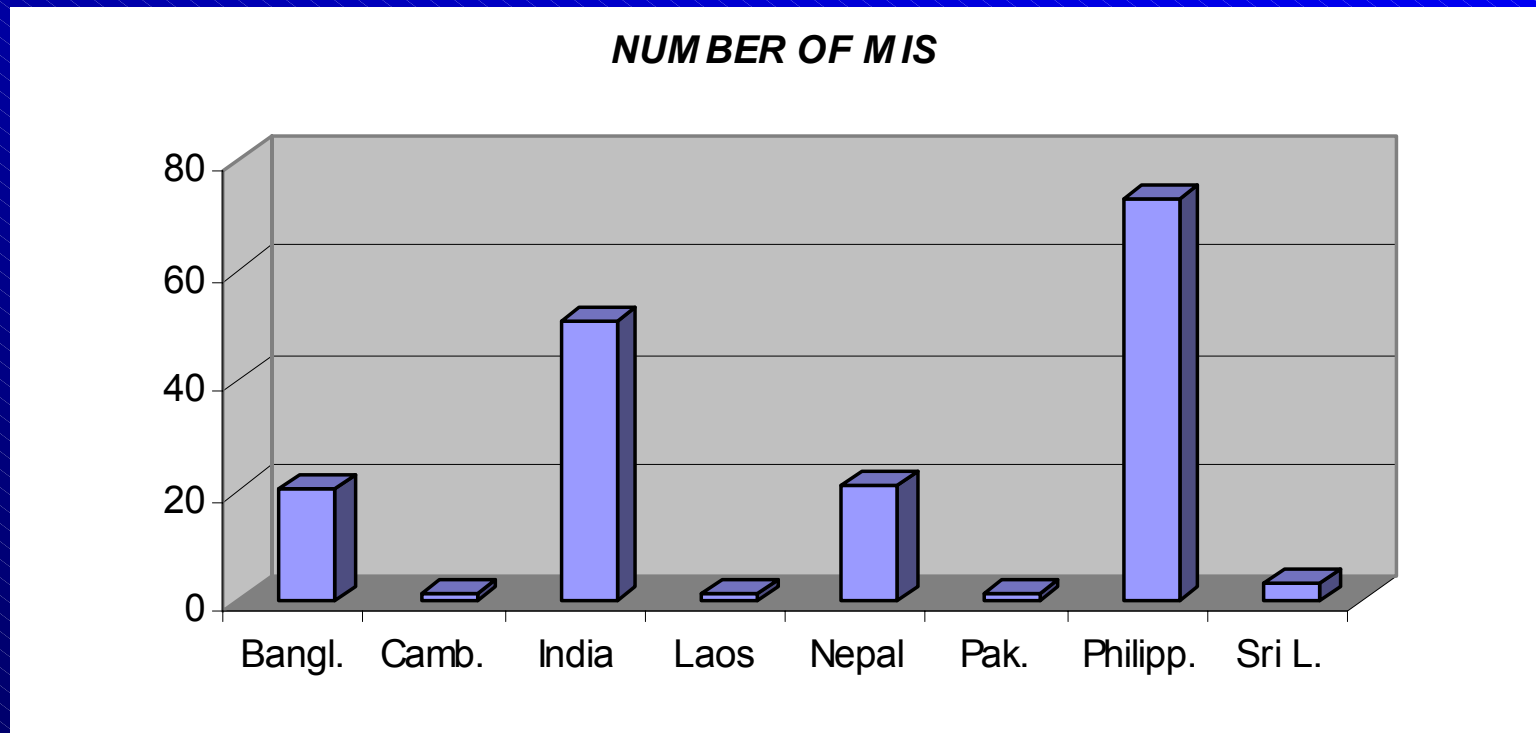
A broader definitions of social protection, using World Development Report 2000/1 framework:

These broader approaches of the WDR 2000/1, as regards to basic needs, do emphasize the importance of:

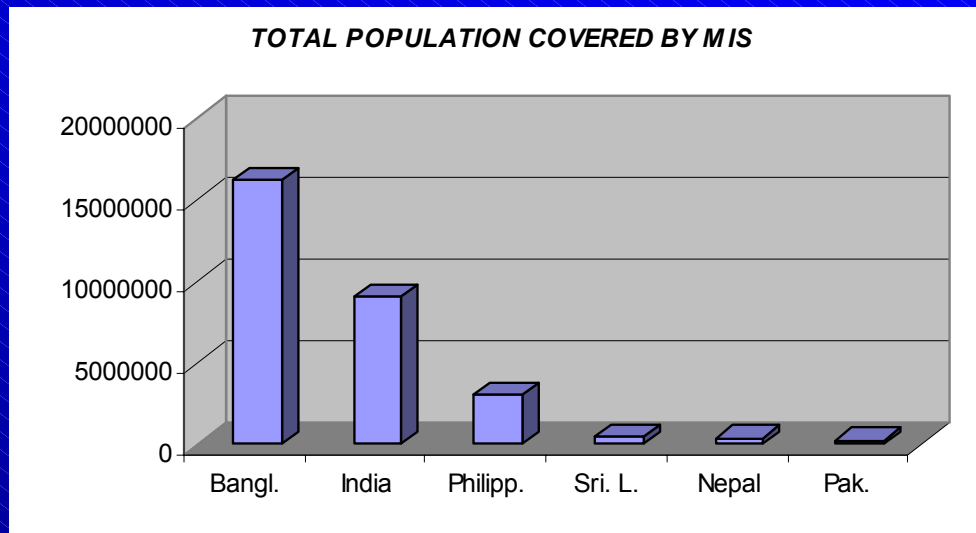
- having access to credit,
- access to markets,
- access to human capital (education),
- providing health needs,
- asset ownership (e.g. land titles, and independent inheritance for women),
- addressing gender and social inequalities, and
- facilitating empowerment in general.

Case studies, examples

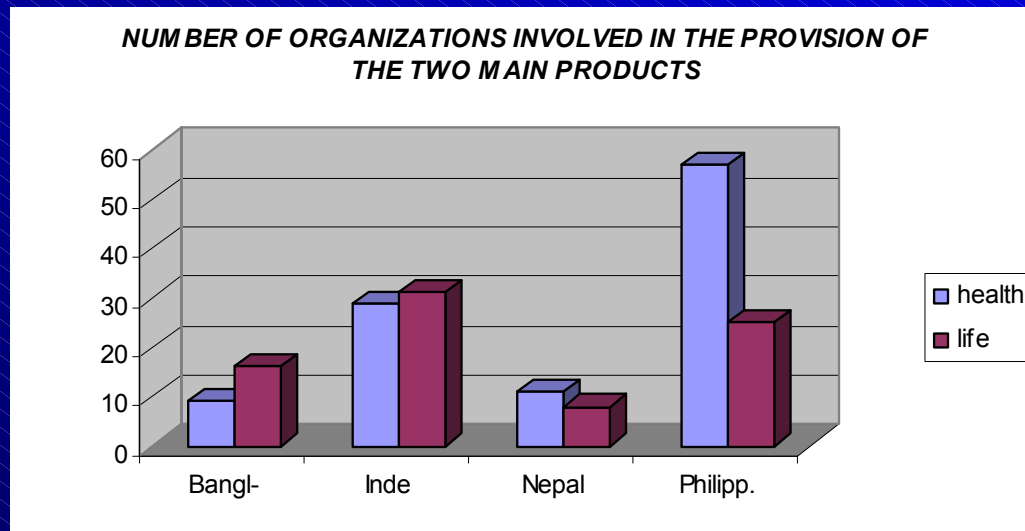
Number of micro-insurance schemes operating in selected countries



Total population covered by the micro-insurance schemes



Importance of life and health insurance products



Technical Assistance to India for Pension Reforms for Unorganized Sector (ADB, TA 4226)

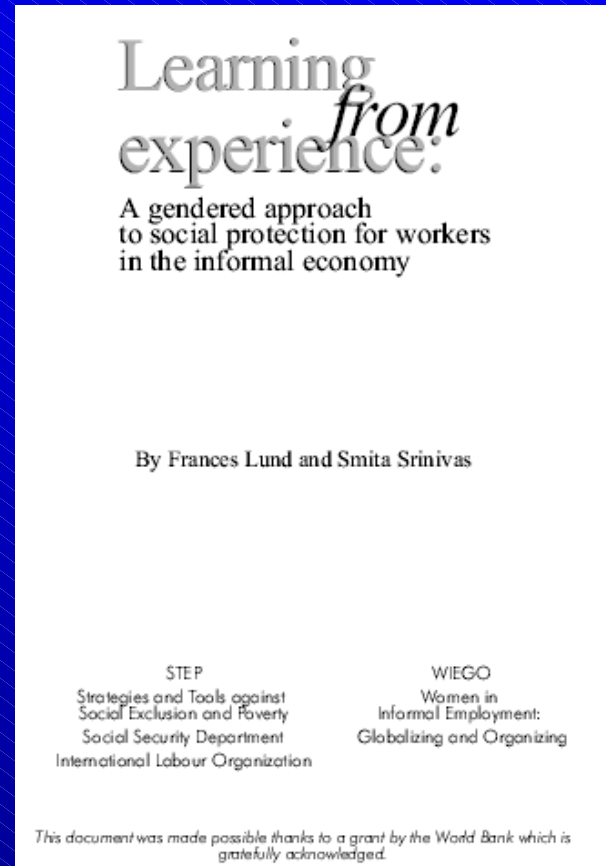
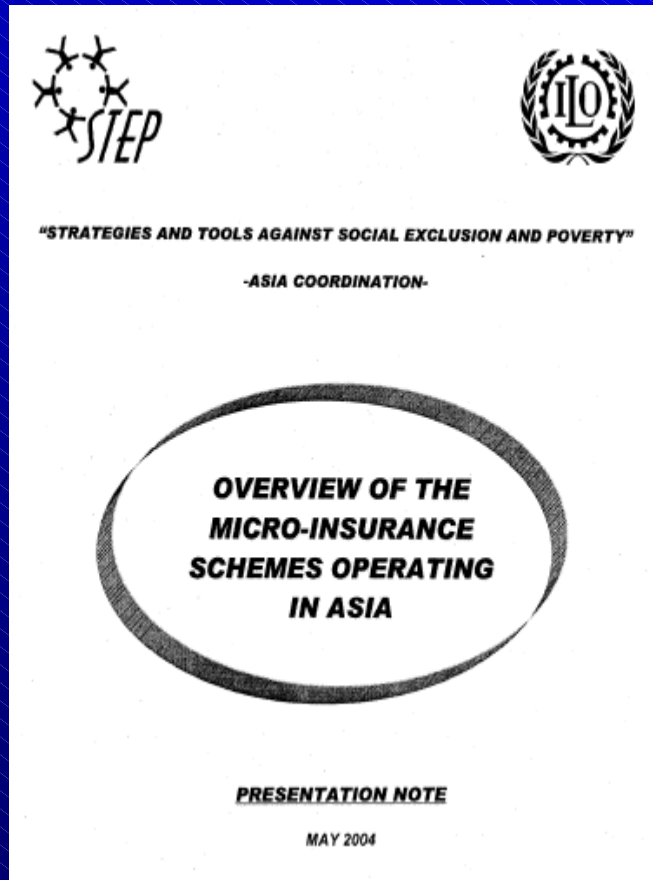
- Goal: Extend benefits of old age security to the unorganized sector of India
- Obj.1 To prepare voluntary privately managed pension schemes to be offered to target participants in the unorganized or informal sector of the Indian economy.
- Obj.2 To help establish a regulatory, administrative, management, and incentive framework and system for the proposed pension scheme for target participants from the unorganized sector.

Technical Assistance to India for Pension Reforms for Unorganized Sector (ADB, TA 4226)

Outputs:

- Database to support pension system development for the sector unorganized sector and PFRDA management and promotional activities,
- Strategic classification of the unorganized sector for planning and implementation purposes,
- Income and attitudinal surveys to close data gaps and develop bases for determining target market, tailor-fit pension product schemes, and develop marketing strategies for reaching out to the target participants, and
- Workshop(s) involving Government and other key stakeholders on above.

Large collection of case studies can be found from these publications:



DISCUSSIONS AND CONCLUSIONS

- The formal sector social protection schemes cover only 10-20 % of the Asian labor force.
- Most formal sector schemes have financial difficulties, and the schemes need to be re-designed.
- The arrangements for social protection in the informal sector cannot rely on the extension of present schemes to informal sector but need to look new and innovative interventions.
- There are a few examples of successful social security reforms as well as community-based approaches, which could serve as examples if they could up-scaled to macro schemes and if their sustainability could be secured.
- Social assistance, both for formal and informal sectors, is necessary also in the future for those who live in or may fall to poverty, and therefore the redistribution of public funds is necessary.

DISCUSSIONS AND CONCLUSIONS (CONT.)

- Universal minimum pension schemes (demogrant or social pension) are good examples also for poverty reduction.
- Considering the increasing budgetary constraints that most governments are facing, this calls for:
 - (i) better governance,
 - (ii) less corruption,
 - (iii) productive private-public arrangements,
 - (iv) strengthened institutions, and
 - (v) improved financial management to secure necessary public funds.
- **Organizing social protection for people in the informal sector is not an easy task, but it can be done.**



END

For More Information:

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ADB Web Site
<http://www.adb.org/SocialProtection>