Social Insurance and Labor Markets

How to Protect Workers while Creating Good Jobs

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Disability pensions
Unemployment insurance
Working conditions
Life insurance
Old-age pensions
Minimum wages
Health Insurance
Why do we care?
Why do we care?

• Myopia:
  - Lack or biased information
  - Limited cognitive skills
  - Psychological problems

• Imperfections in labor markets

• Imperfections in capital markets

• Imperfection in insurance markets (adverse selection)
What are the problems?

- Low coverage
- Design problems that distort labor markets:
  - Lower participation rates
  - Lower employment levels
  - Higher informality
COVERAGE
Coverage is discontinuous

- **Argentina**: Low contribution density (22.5%) in the lowest quintile, high contribution density (90%) in the highest quintile.
- **Chile**: Lower contribution density (around 22.5%) in the lowest quintile, and higher contribution density (67.5%) in the highest quintile.
- **Uruguay**: Moderate contribution density (around 22.5%) in the lowest quintile, and high contribution density (90%) in the highest quintile.

The graph illustrates how coverage density varies across different quintiles in Argentina, Chile, and Uruguay.
Why ?
Why?

- Many are self-employed
- Unemployment
- Labor mobility
- Low income individuals can't afford contributions
- Low productivity firms can't afford pay-roll taxes
- Evasion?
Unemployment is an issue

Inflow rates (% employed)

Unemployment duration (months)

Combinations consistent with a 5% unemployment rate.
Unemployment risks are higher in the informal sector...

- Informal W (3.8%)
- Informal SE (2.85%)
- Informal E (1.05%)
- Formal W (1.11%)

Brazil
There is also considerable mobility between jobs

<table>
<thead>
<tr>
<th>Annual Transition Rates</th>
<th>Self-employed</th>
<th>Informal</th>
<th>Formal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-employed</td>
<td>--</td>
<td>0.53</td>
<td>0.35</td>
</tr>
<tr>
<td>Informal</td>
<td>0.29</td>
<td>--</td>
<td>0.47</td>
</tr>
<tr>
<td>Formal</td>
<td>0.25</td>
<td>0.43</td>
<td>--</td>
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</tbody>
</table>
Tax-wedge reduces formal employment (0.1-0.5 elasticity).... low productivity firms self-select in the informal sector.

**Value added per worker**

**Minimum cost of labor**

**MOROCCO**

**Excluded**
What has been the solution?
What has been the solution?

• Creating specific programs for groups which are not covered...

• ... often, non-contributory
Programs have been effective in expanding coverage, but bring other problems...
LABOR MARKET DISTORTIONS
How do SI programs affect labor markets?

Workers do not value benefits "in full"

Contributions not linked to benefits

Non-contributory insurance

Behaviors of employers and workers
Example of implicit redistribution in UB programs

<table>
<thead>
<tr>
<th>Balance in the individual account (% of wage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
</tr>
<tr>
<td>-37.5</td>
</tr>
<tr>
<td>-75</td>
</tr>
<tr>
<td>-112.5</td>
</tr>
<tr>
<td>-150</td>
</tr>
</tbody>
</table>

-4% contribution rate

50% replacement rate during 3 months

Months:
1  2  3  4  5  6  7  8  9  10  11  12  13  14  15  16
Imagine...

PLAN MEMBERS

LOW RISK
Unemployment rate = 3%
Duration = 3 months

HIGH RISK
Unemployment rate = 10%

REPLACEMENT RATE = 60%
CONTRIBUTION RATE = 4%
LOW RISK

100 months of contributions

HIGH RISK

3 months of benefits

4 meses de salario

1.8 meses
Implicit taxes can be significant...
What is the evidence?
Tax-wedge

The difference between the total cost of labor and take-home pay

Tax Wedge = \( W \cdot (1 + \text{taxE}) - W \cdot (1 - \text{taxW}) - \text{Value SS benefits} \)

\( W \): wage
\( \text{taxE} \): taxes paid by employer (social security contributions)
\( \text{taxW} \): taxes paid by workers
What is the evidence?

Non-contributory programs provide incentives for informal work (Mexico and Colombia)

Transfers (social pensions) can reduce formal employment and participation (Chile)

Workers valuation of mandatory benefits (health care) affects the choice between formal and informal jobs (Uruguay)

8-20% of net formal employment creation

- 4.1% formal participation of workers older than 40

Higher propensity of women with children to drop out of labor market

- 5% among plan members with no children
Mandatory savings rates and default portfolios do not account for different “preferences” and observable characteristics that matter (e.g., labor income).
Unemployment insurance can affect unemployment rates and the share of formal, informal and self-employment (Brazil)
Policy Framework to Guide Reforms
Recommendations at five levels

- Integration of SI programs
- Bundle and level of SI benefits
- Redistribution
- Financing and tax-wedges
- Incentives for enrollment
Integrate programs

• Have one SI system open to all workers

• This can be done by "shutting-down" schemes and re-enrolling workers ...

• ... or closing schemes to new entrants, who would enroll in a national scheme
Review the bundle of SI benefits

- Focus on pensions (old-age, disability, survivorship) health insurance, and unemployment insurance

- Give more choice to individuals in defining the level of benefits:
  - Define a basic bundle of benefits as a default
  - "Nudge" individuals to update their defaults and provide information/guidance
Make redistribution explicit and well targeted

- Link contributions (including from employers) to benefits

- Identify the share of the cost of the bundle of SI benefits that will be subsidized at each level of income (could be universal):
  
  - Subsidies can match the contributions or top-up the benefits of plan members...

  - ... there has to be a "smooth" decline in the subsidy based on income

- Income can be inferred through proxy means tests (PMT)
Income Level

Benefit

Subsidies

Contributions

Income Level
Income Level

Benefit

Voluntary contributions

Subsidies

Income Level
Reduce tax-wedges

- Having more individual choice in defining the bundle of SI benefits can help...

- Also linking contributions to benefits and financing redistribution through general revenues:
  - Reallocate expenditures (e.g., subsidy reform)
  - And/or increase other taxes (e.g., consumption, property, wealth)

- Consider exemptions for firms below a given level of productivity
Incentives to enroll

• With large informal sectors it is not possible to enforce enrollment... it has to be voluntary

• Administrative processes must be simple

• Rely on "aggregators" that operate in small villages and markets, as well as through cooperatives

• Rely on mobile technology

• Run information campaigns

• Provide financial incentives:
  • Those who enroll are eligible for a minimum level of benefits and/or matching contributions
Final remarks

• There are important problems with coverage, labor markets, and equity

• Part of the solution is to integrate programs, have more choice, and rethink redistributive arrangements

• The political economy of reform is not easy

• But making redistributive arrangements explicit can help