



Making the Case for Social Insurance and Protection in Low- and Middle-Income Countries

The 6th IZA/World Bank Conference on Employment and Development
Held in Mexico Under the Auspices of the President of Mexico

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CONTACT: Mark Fallak
PHONE: +49-228-3894-223
E-MAIL: fallak@iza.org

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How to provide insurance and security to people working in the informal sector was the key theme of the 6th IZA/World Bank conference on “Employment and Development” held in Mexico City on May 30–31, 2011.

Having more insurance and social protection is critical because it can increase the population’s acceptance of labor market reforms, such as the introduction of more flexible labor contracts. However, as was stressed emphatically by Mexico’s President Felipe Calderón in his keynote address to the conference, for all the economic virtues and benefits, political economy considerations can hinder any reform process. He laid out the difficulties he has encountered in his country’s parliament in seeking to reform the labor laws, which have been basically unchanged since 1970, in order to make the country’s economy more competitive.

According to IZA Director Klaus F. Zimmermann’s opening statement, global poverty can be ameliorated through the creation of jobs — but in the absence of formal-sector jobs, governments must step in to provide basic social insurance. To this end, the IZA/World Bank conference series brings together policymakers, researchers and representatives of international institutions to foster a better understanding of the informal sector and the effectiveness of labor market reforms in emerging and developing economies — and in determining how policies that have been successfully employed by developed countries such as Germany can be adapted to the unique circumstances of developing economies.

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In another keynote speech, Javier Lozano, Mexico's Secretary of Labor and Social Welfare, stressed the urgency of the need for reform in order for low- and middle-income countries to take advantage of the demographic dividend. Using as an example the case of Mexico, whose population at an average age of 27 years is very young, demographic aging implies that reforms of labor and social protection will only become more difficult in the years ahead, as an ever bigger share of the population ages, needing pensions and requiring more expensive medical care.

Birol Aydemir, the Turkish Undersecretary of Labor and Social Security, pointed out that "informality is a social disease" with very negative consequences for the economy and the society. He also underscored the importance of designing social protection systems carefully programs so that they do not deter employment and promote informality. Mr. Aydemir outlined the measures his government has been undertaking to combat informality, including increased enforcement (inspections, controls and penalties), awareness-raising, greater incentives for firms to hire formal workers, and reducing disincentives for (informal) workers receiving non-contributory health insurance (the so-called Green Card in Turkey) to get formal jobs. These measures have contributed to the reduction in job informality from 48% in 2005 to 41% in 2010.

Carmen Pages of the Inter-American Development Bank underscored the need for better social protection for the informal sector. An aging population and the vanishing of traditional protections via the extended family will leave more and more people unprotected. While in the past an average of six children took care of their parents, with smaller family sizes the burden now rests on only one or two children. The continuous migration from rural to urban areas also makes traditional old-age caring arrangements between parents and children less reliable. She also suggested making contribution rates to contributory systems progressive so that the disincentives to join the system are smaller for poor people.

David Robalino, leader of the World Bank's Labor Team, indicated that while general revenue financing of a basic package of social insurance benefits can help eliminate labor market distortions, it might not always be feasible. Robalino stressed the need to eliminate implicit redistribution within social insurance programs by linking contributions to benefits as a way to reduce the tax wedge. This can be achieved by moving from Defined Benefit to Defined Contribution pensions, from unemployment insurance to unemployment savings accounts, and by asking individuals to contribute to health insurance on the basis of "premia," as opposed to a share of earnings. Explicit

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redistributive arrangements that do not depend on where individuals work can then be designed to cover those with low or limited savings capacity.

While most conference participants agreed that social protection for the informal sector is needed, the perfect solution of contributory and/or non-contributory systems has not yet been found. There was a clear consensus, though, that a certain unbundling of the insurance components would be needed: While universal systems might work best for health insurance, particularly for serious health shocks, old-age pensions could require different systems. As Robert Holzmann (University of Vienna) stressed, one should not force poor people into mandated pension schemes. Their need for liquid funds is higher than the need for long-term illiquid savings.

Professor Gary Fields (Cornell University) also made a plea for providing a basic security to everyone. He would rather see people abstain from work and have a basic income than taking up very dangerous jobs. Employer of Last Resort schemes, in which the government guarantees any person the right to 100 days of remunerated public work each year, would be one way in which the government could provide basic security to everyone. Similar schemes have been introduced in India and Argentina.

As an alternative vision, other speakers — including Professor Laurence Kotlikoff (Boston University) — laid out that it would be good if poor people were saving more money, which would help them cope with smaller to medium shocks. He acknowledged that poor people often do not have access to safe and sound saving products. In addition, people do not always behave rationally: Even though they know that saving is important, they face so many pressing demands that they postpone starting to save. Helping people to overcome behavioral myopia by offering clever saving products, e.g. insurance savings accounts, could help to reduce their vulnerability. He has urged governments to sponsor the establishment of personal retirement accounts — the government providing matches for poor, unemployed or disabled citizens — whose contributions would be invested in a global index fund.

Note to reporters:

Attended by more than 100 policymakers, researchers and representatives of international institutions, and organized by the Institute for the Study of Labor (IZA) and the World Bank, under the auspices of the President of Mexico, this year's conference was co-organized and cosponsored by the Instituto Tecnológico Autónomo de México (ITAM) and the Inter-American Development Bank (IDB).

The annual IZA/World Bank conferences on "Employment and Development" were initiated in 2006 and are devoted to finding possible solutions to nurture the creation of better jobs and income opportunities. More and better jobs are needed in Latin America, Africa and Asia. Employment, more jobs and better earnings opportunities are the main route for these countries to escape from poverty and to prosper.

For the full program of the conference and the policy forum, click here:

http://www.iza.org/conference_files/worldb2011/

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