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POLICY NOTE SERIES

Providing a Framework for Constructive Debate Among Policymakers & Experts

Making Universal Social Insurance a Reality

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1. The Problem

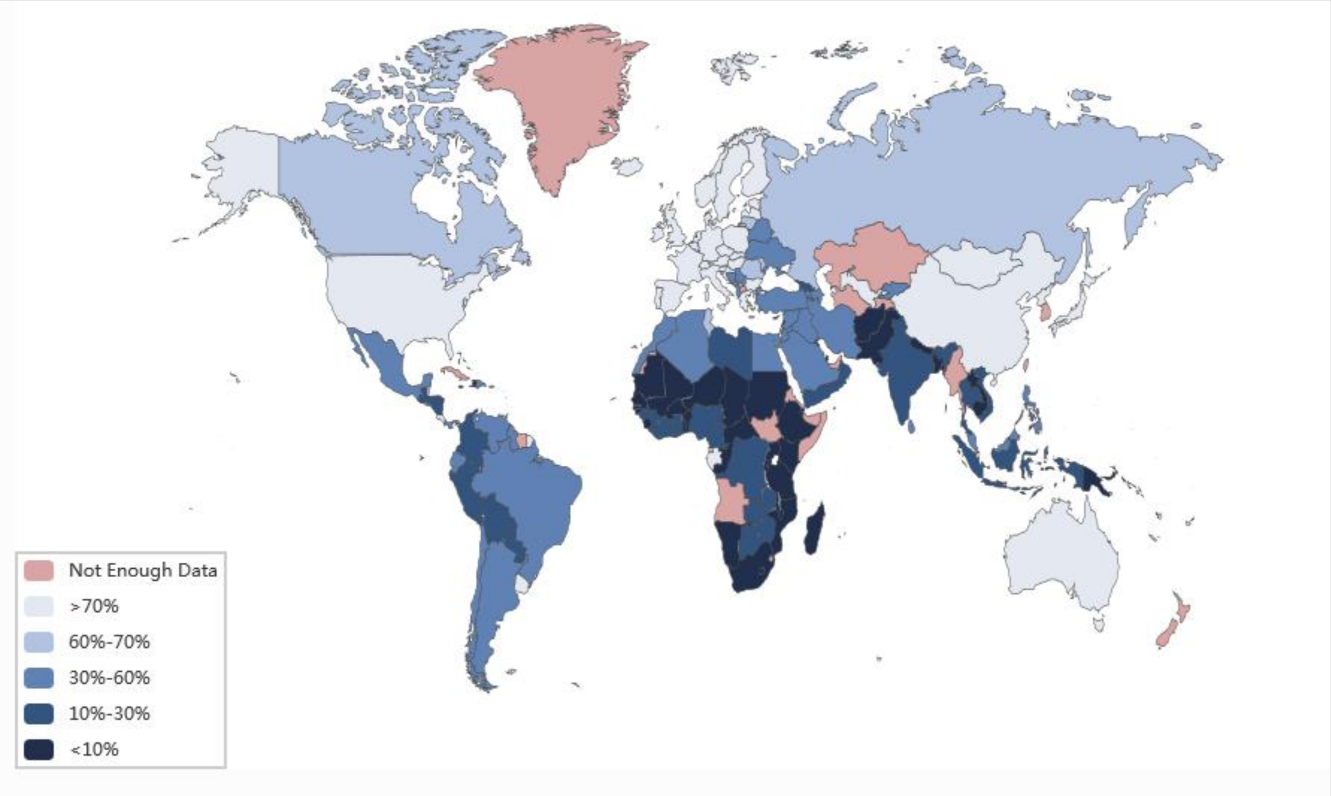
Throughout their lives, workers and their families are exposed to various shocks that affect their consumption patterns and quality of life. For instance, becoming disabled or sick, experiencing the death of a family member, losing a job, or not having enough income during old-age.

It is difficult to insure against the risk of experiencing these shocks through private arrangements only. One reason is that many people cannot afford private insurance. But, in addition, private markets for insurance are notoriously difficult to navigate. Problems related to adverse selection and moral hazard are pervasive. Also, consumers tend to underestimate risks or lack the self-control and discipline to save enough and buy insurance; they are affected by cognitive biases.

Most countries therefore have setup social insurance programs, but their coverage is often low.[1] Public systems such as old-age, disability, and survivorship pensions; severance pay and/or unemployment insurance; and social health insurance cover mainly formal wage employees in medium and large enterprises and the public sector. Except for high-income countries, coverage rates are usually below 50% of the labor force.

Across countries, coverage rates tend to increase in line with the level of economic development. But even in middle-high income countries such as Chile and Mexico coverage rates remain below 60%. The problem, of course, is much more serious in low-income countries where less than 10% of the labor force has access to social insurance

FIGURE 1 CONTRIBUTORY SOCIAL INSURANCE COVERAGE RATES ACROSS THE WORLD (% OF LABOR FORCE)



Coverage of mandatory social insurance as proxied by the number of active contributors to a public pension scheme as a share of the labor force data from World Bank (WB) & International Labor Organization (ILO)

[1] In this note we only discuss the issue of population coverage. We do not analyze the scope of risks covered or the adequacy of benefits.

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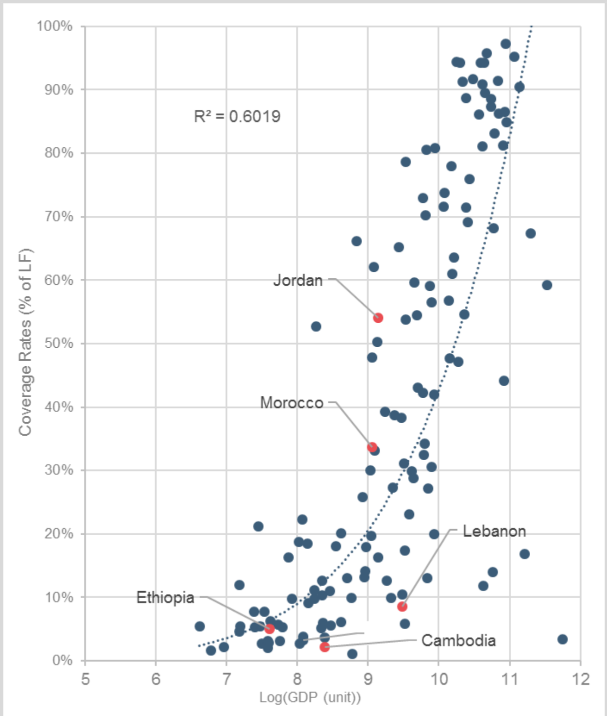
programs. In Ethiopia, 5% of the labor force is covered and in Cambodia only 2%. In middle income countries coverage rates[2] tend to be higher but rarely surpass 50%. In Jordan the coverage rate is 54% but in Morocco only 34% and in Lebanon 9% (Figure 2).

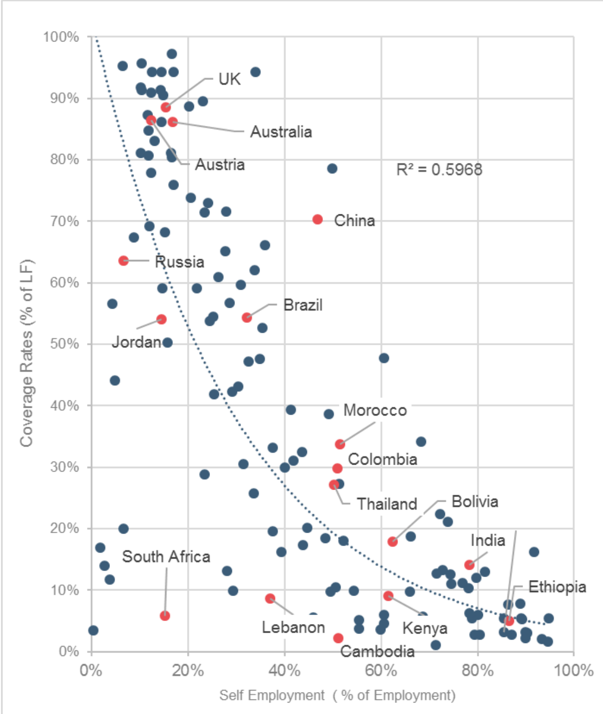
FIGURE 2 SOCIAL INSURANCE COVERAGE RATES & GDP



Calculations based on WB Data ILO statistics

Not surprisingly, coverage rates are mainly influenced by the structure of the labor market. Most social insurance programs are designed for workers who have an employment contract. Wage employees in small, low-productivity, enterprises and the self-employed (including farmers) are seldom covered by these programs. Thus, countries with a high share of self-employed workers and/or famers, have also low coverage rates. (Figure 3).

FIGURE 3 SOCIAL INSURANCE COVERAGE RATES & SELF-EMPLOYMENT



Calculations based on WB Data ILO statistics

One solution that many countries have pursued to deal with the problem of coverage is to implement non-contributory or quasi-non-contributory programs for the informal sector. Some twenty countries, for instance, have implemented non-contributory health insurance for the poor and, in some cases, informal sector workers (Figure 4)[3]. Many more have introduced social pensions (Figure 5). These programs have had a sizeable impact on coverage rates. In Thailand, for instance, non-contributory health insurance covers over 70 % of the population (Figure 4). In China, social pensions cover 70% of the elderly population (60+) and in Bolivia close to 100% (Figure 5).

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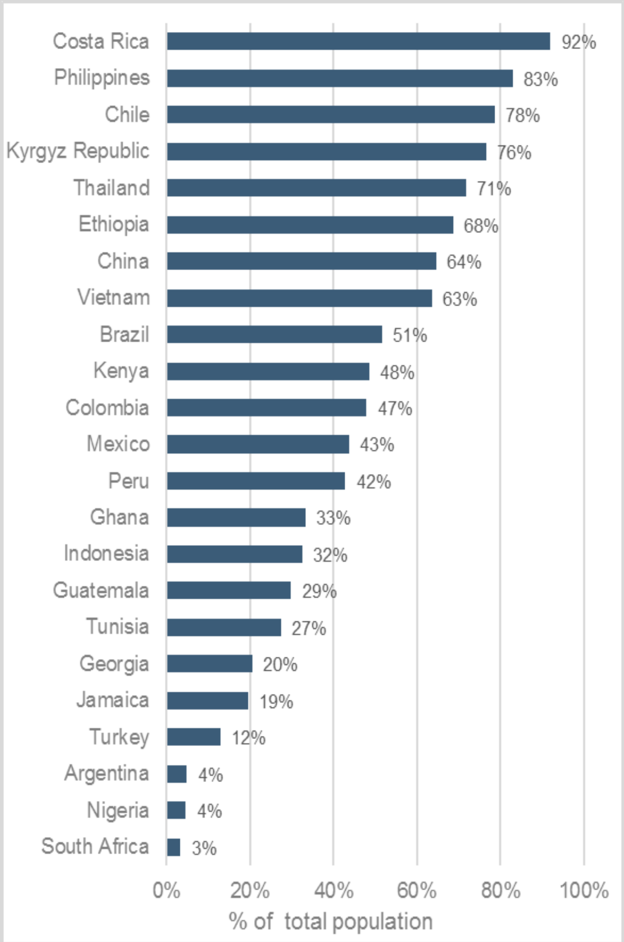
[2] Percentage of coverage only includes contributory public schemes.

[3] The majority of countries also run national health services which supposedly cover the entire population but the quality of care if lacking and vulnerable workers tend to face severe access problems. There are also other initiatives such as Community Based Social Health Insurance, particularly in East Africa, but their coverage is small and there are important problems in terms of design and implementation.

FIGURE 4 COVERAGE OF NON-CONTRIBUTORY HEALTH INSURANCE



Calculations based on WB Data

These parallel programs, however, have problems of their own. First, they usually offer lower levels of benefits. The social pension in Ecuador, for instance, represents only 7.5% of economy wide average earnings whereas the minimum pension in the contributory system is equal to 50% of average earnings. The same happens with the content of the basic health package offered by non-contributory programs. Countries like Colombia and Peru have tried to align the content of these packages but, in practice, differences persist.

Second, coverage does not always extend beyond the poor. Indeed, some programs do not cover workers in the middle of the income distribution, who are usually informal sector workers and part of the vulnerable middle-class, do not have coverage. This is an issue particularly in middle income countries.

FIGURE 5 SOCIAL PENSION COVERAGE OF THE 60+ POPULATION

Calculations based on IMF World Economic Outlook & UN Population Division Data

Third, having parallel non-contributory programs fragment the labor market, which can reduce incentives for the creation of formal jobs. This is probably not a very important issue in low income countries where the informal sector is very large and where transitions between formal and informal work are rare. In middle and high-income countries, however, workers often move between formal and informal work. Non-contributory programs can then act as a tax on formal employment: workers who take formal jobs lose the subsidies and in addition have to pay Social Insurance contributions.

Finally, expanding coverage on the basis of purely non-contributory arrangements can sometimes be unaffordable for countries. It is estimated, for example, that in a country like Bolivia, Colombia, Ecuador, and Peru non-contributory coverage for the entire population could cost between 12% and 15% of GDP.

2. An Alternative Strategy

Instead of setting up parallel systems, countries can consider reforms to have **integrated social insurance programs** that can be extended to all workers. Indeed, there is no economic rationale for having parallel systems. All workers should be treated equally and, regardless of the type of job they have, enroll in the same system. The only difference could be in terms of how much and how often they pay – if there are payments to be made.

A first step to move towards an integrated social insurance system is to **define explicitly, and cost, the benefits offered**. In the case of health insurance this implies defining the content of the health package and the premium that would need to be paid to finance it. For pensions and unemployment insurance it implies defining the share of income that would be replaced when an individual retires or becomes unemployed, and the level of the contribution rate that would need to be paid for the system to be financially sustainable. In this way, the government knows what the cost for each new member joining the schemes is and can decide on the best type of financing mechanism: payments by beneficiaries, employers, and/or the government.

The second element is to have **transparent and efficient redistributive arrangements**. Clearly, not all workers can pay the necessary contributions and/or premiums to fund benefits; subsidies are necessary. These subsidies, however, should be transparent and should not be allocated based on where people work. The subsidies are either universal subsidies or subsidies allocated based on means/needs. The subsidies would be financed by general revenues and not by taxes on labor.

With the right polices in place, the first step to initiate the expansion of the system involves **identifying, enrolling, and profiling workers and their families**. In principle, these are straightforward activities that only require having the right administrative systems and resources to manage logistics. Enrollment can be done "on-demand" and through *census swaps*. This implies that, in a relatively short period of time, everybody can have an account with the social security. During the enrollment process the institution in charge of administering the system can also collect the data to assess the payment capacity of different individuals through Proxy Means Tests (PMTs). This assessment is needed to allocate subsidies when they are not universal. When doing so, however, it is important to reduce the risk of exclusion errors that might affect the most vulnerable workers. This can be done, for instance, by targeting subsidies only above the fourth or fifth decile of the income distribution [4]. In general, countries would need to assess the benefits and costs of targeting subsidies, including the costs related to the development and implementation of the PMT.

A more complex undertaking is **collecting contributions/payments from plan members**. This is particularly difficult in the case of informal sector workers. It is possible to do it, however, if governments coordinate four types of interventions:

- *Digital payments platforms*. Many countries, including low-income countries, already have platforms that allow users to execute financial transactions using their mobile phones, such as Kenya's M-PESA. Enabling these platforms is a pre-condition for the extension of coverage.
- *Conditionalities to access public goods and services*. Social insurance programs should be mandatory; voluntary schemes have had limited success. To ensure compliance, government can condition access to certain services (e.g., obtaining a drivers' license, public education) to the regular payment of the necessary contributions.
- *Financial and non-financial nudges*. There is evidence that contribution subsidies (i.e., matching contributions), information, and reminders by text messages increase the probability of making payments/contributions to social insurance systems.
- *Payments at the point of consumption*. Probably the most promising innovation is to collect contributions in a way similar to a sale tax. The limitation is that many good and services are sold in informal markets. Nonetheless, transactions such as

[4] It is important to clarify that universal coverage – everybody has access to social insurance programs—does not imply universal subsidies

recharging mobile cards, using ATM machines, or paying for internet services take place in formal markets even in lagging regions. In addition, in countries like China and Bangladesh, digital payments using QR platforms are expanding even to the informal sector. They just require a mobile phone, access to the internet, and a bank account.

3. Implementation Challenges

Reforms to expand social insurance coverage are complex, can take several years, and require careful planning. As discussed above, before expanding existing systems it is necessary to fix their design, including to reduce administrative expenditures, and this is often politically difficult. Countries also need to have the necessary fiscal space, not only to finance new benefits but also to absorb the unfunded liabilities of existing systems. In addition, the demands in terms of human resources and new management and information systems for the reformed programs are not trivial.

In general, countries that succeed in designing complex reform programs, tend to have a better functioning "policy making process." They have: 1) strong leadership; 2) good "aggregators" that can reduce the number of actors who can directly influence policy; 3) open dialog and continuous interactions among these actors within a long-term planning horizon.

It is also important to align the pace of reforms with existing capabilities. Reforms that are too ambitious given the institutional context can backfire. The alternative is to set more modest goals while gradually filling existing gaps in capabilities. To this end, it is necessary to understand what are the tasks/functions that need to be accomplished to design and implement different aspects of the reform program (e.g., policy analysis, preparing legislation, logistics, processing transactions, enforcement) (Table 1).

In terms of fiscal space there are different options to be considered. In low and middle-income countries there is still room to gradually increase revenues from taxation, either income or consumption taxes. There is also often room to increase efficiency in the allocation of the existing budget. A better management of the public debt can also free up resources and/or enable investments during the implementation period.

TABLE 1 TASKS/FUNCTIONS AND CAPABILITIES FOR EXTENSION OF COVERAGE

Task / Function	Capabilities	Examples
Policy analysis **Policy making**	Analytical Technical	Design pension system Analysis of fiscal impacts Costing health plan Drafting new legislation
Logistics	Transaction intensive Mastery of existing technologies	Enroll plan members Proxy means tests Pay benefits
Service delivery	Analytical, technical, and socio-emotional Discretion Mastery of existing technologies	Health care Training and counseling
Enforcement of obligations	Transaction intensive Mastery of existing technologies Technological innovation Discretion	Collect contributions

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