Pension Notes

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# Mechanisms for the inclusion of informal workers in social security

Federación Internacional de Administradoras de Fondos de Pensiones

***Executive summary***

*Latin America faces the serious problem of informal employment: one in two workers in the region is informal. This situation not only leaves these workers totally unprotected against incidents during their working life, but also condemns them facing old age without a decent pension.*

*Unfortunately, informal employment has unavoidable consequences for future pensions, especially for younger workers. Estimates made for the Chilean case show that when a worker does not contribute during the first years of his working life, his pension is reduced by close to 72% in the case of women and to 73% in the case of men.*

*In this way, informal employment becomes one of the fundamental causes of both the low coverage and the low amounts of pensions in our region. Therefore, if we want to move towards more robust pension systems, it is necessary to take charge of this important group of workers, promoting the formalization of employment, but also designing innovative strategies that allow them to join social security through non-conventional mechanisms.*

*Traditional social security systems created with stable labour relations between employers and workers in mind often do not adjust to the reality of informal workers, self-employed workers or workers with fluctuating incomes. These workers may have difficulty making the regular monthly payments required by social security due to their variable income, which may be difficult for them to afford. Therefore, to achieve their incorporation, it is key to making traditional systems more flexible so that informal workers can be included.*

*Concerned about this reality, FIAP, through a review of international experiences, presents in this note seven suggestions for the incorporation of informal workers in particular:*

*1. Unique tax ("Monotributo")*

*2. "Sachet" strategy*

*3. Collection through patents or invoices for services*

*4. Quotations through consumption*

*5. Strategies from behavioral economics*

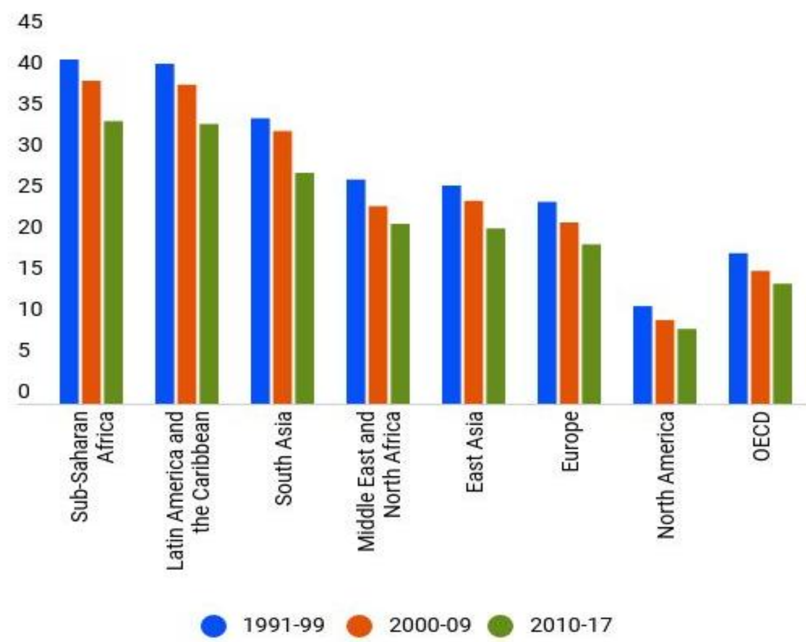
*6. Information campaigns and use of social networks*

*7. "SeLFIES" (Standard of living indexed Forward Income Securities) or retirement bonds*

1. **Background: Latin America has high levels of informality**

According to data from the International Labour Organization (ILO)[1], Latin America is the second region in the world with the highest labour informality. By mid-2023, informal workers accounted for 48% of the total employed population, a figure surpassed only by Sub-Saharan Africa. However, when measuring the participation of the informal economy as a percentage of GDP (Figure N° 1), it is observed that during the 2010–17 period, Latin America and Sub-Saharan Africa are at the same level, with 34% of GDP, while the average for OECD member countries reaches 15% of GDP.

**Figure N°1. Informal economy as a percentage of GDP (%)**

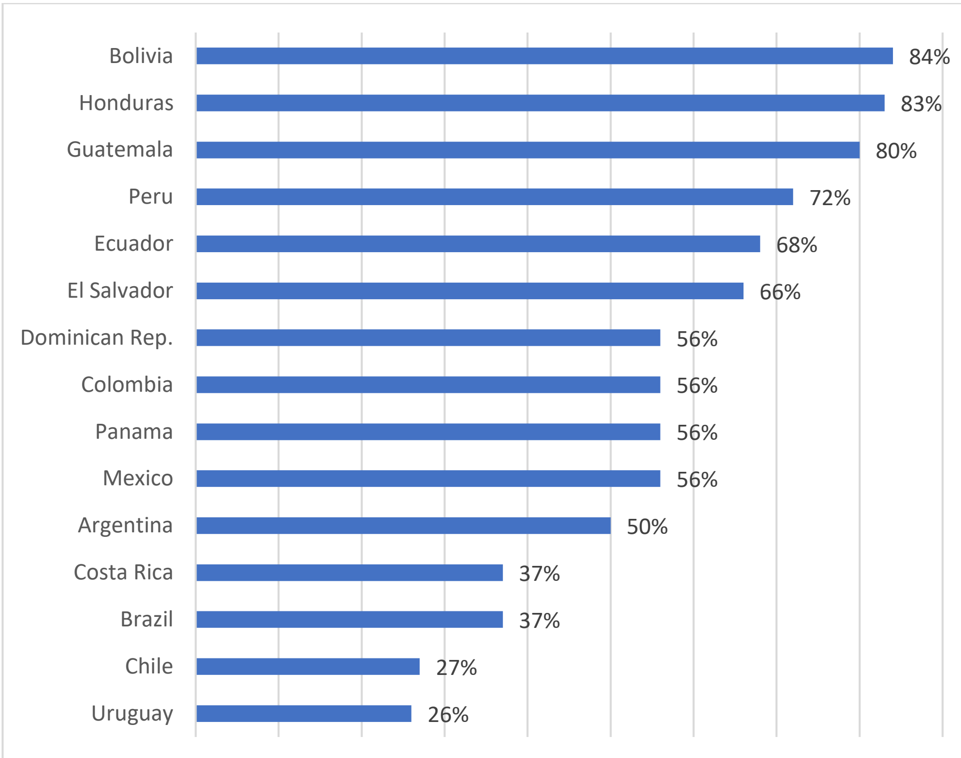



**Source**: Medina and Schneider (2019).

When breaking down the data at the country level (Figure N° 2), we find countries such as Bolivia, Honduras, and Guatemala, where informality levels exceed 80%; but let's not leave aside member countries such as Peru and El Salvador, where informality represents 72% and 66% of the labour force, respectively. In other words, approximately 2 out of every 3 workers are informal.

[1] OIT (2023), Labour Overview 2023 Latin America and the Caribbean.

**Figure N° 2. Latin American countries, 2023 or latest available figure: percentage of informal workers out of the total labour force**




**Source:** FIAP based on ILO data.

These figures should alert us to the situation of informal workers, especially because after the COVID-19 pandemic, we have observed a substantial increase in informality in the region. For this reason, in this pension note, FIAP presents 7 proposals to enable informal workers to be incorporated into social security.

## 2. Informality has irreversible consequences on pensions

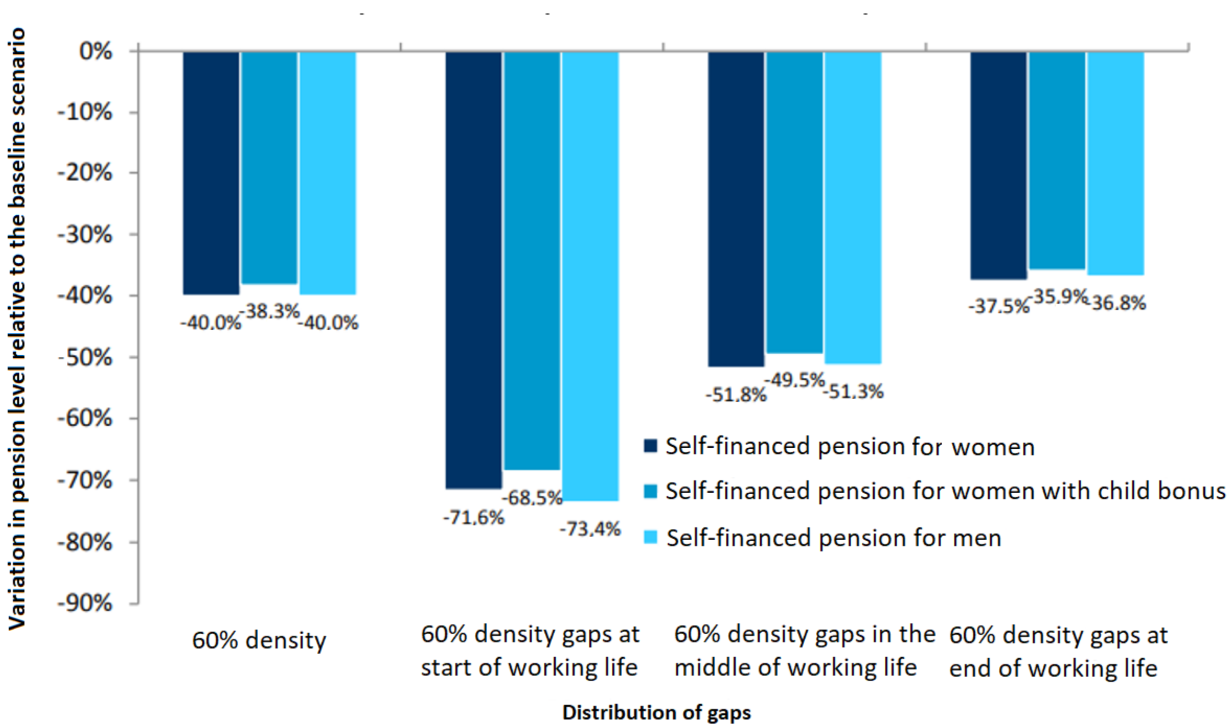
Workers in the informal sector generally have lower incomes than formal workers, which prevents them from saving for unexpected events. They do not contribute enough to secure sufficient pensions and, therefore, have a higher probability of living in poverty during old age. Additionally, they lack protection against other risks for which social security provides coverage (illness, maternity, death, or unemployment).

A serious problem with informality is that its consequences on pensions are irreversible. A study conducted by Chile's Superintendency of Pensions (2018)[2] simulates the loss in pension amounts for a worker who contributes for only 60% of their working life instead of 100%. The results show that the decline in pension amounts depends on the stage during which the non-contribution period (gaps) occurs. As illustrated in Figure N° 3, for men, if a worker does not contribute at the beginning of their working life, their pension would be 73.4% lower; if the non-contribution period occurs in the middle of their working life, the pension would be 51.3% lower; and finally, if the non-contribution period occurs toward the end of their working life, the pension loss would be 36.8%. These results demonstrate that contributions at the beginning of a worker's

[2] Granados, P., C. Quezada, and X. Quintanilla (2018). *Determinants of Pension Levels.* Working Papers No. 59. Chilean Superintendency of Pensions.

career are very important for building a future pension, making it critical for young people to start their working lives in formal employment.

**Figure N° 3. Chile: Percentage variation in pension due to decreased contribution density, depending on the stage of working life, by gender**




**Source:** Granados, P., C. Quezada, and X. Quintanilla (2018).

### 3. Proposals to Incorporate Informal Workers into Social Security

The formalization of employment depends on factors whose effects materialize over the long term, such as economic growth and productivity, the formation of human capital, trade openness, tax efficiency, and low-bureaucracy regulation. All these measures should be pursued by Latin American countries and become our medium- and long-term objectives.

However, we are currently facing the reality that, on average, one in two workers in the region is informal and we cannot wait for these policies to take effect before addressing their vulnerable situation. To do so, it is necessary to adjust social security systems so that they allow access to informal workers.

Traditional social security systems designed with stable employment relationships between employers and workers in mind often do not fit the reality of informal workers, self-employed workers, or workers with fluctuating incomes. These workers may have difficulty making the regular monthly payments required by social security due to their variable incomes, which may be unaffordable for them. The World Bank (2024) suggests adapting social security systems to meet the diverse needs of a broad group of workers, ensuring accessibility and practicality. Key design ideas include:

• Offering automatic, small, and flexible payment options.

• Offering both monetary and non-monetary incentives.

• Streamlining the registration process using existing identification systems.

• Simplifying procedures with digital technology.

• Establishing registries of potential self-employed workers through partnerships with digital employment platforms.

• Using behavioral nudges to encourage participation.

This note offers, based on a review of successful international experiences, seven possible mechanisms for incorporating informal workers into social security.

### 3.1 Unique tax

Unique tax is a simplified tax collection scheme designed for small contributors. This scheme reduces the complexity of administrative procedures and the payment process, facilitating entry into the formal economy. The idea is that individuals who meet certain criteria (mainly small business owners) pay taxes to the state and are covered by social security.

Among the simplified tax regimes, those that include both taxes and social security contributions in their design stand out. This approach is present in countries such as Argentina, Brazil, and Uruguay.

In Argentina, the unique tax system was introduced in 1998. This system establishes 11 categories based on annual income to calculate the tax component. Merchants, members of work cooperatives, and individuals in vulnerable socio-economic situations can opt for this regime. Through their contributions, unique tax participants gain access to health services and a pension for old age.

In Brazil, the system was created in 1996 in Brazil at the federal level through the SIMPLES federal regime. In 2006, the SIMPLES national regime was created, replacing and integrating simplified regimes at the federal level. Later, in 2008, the microentrepreneur individual regime (MEI) was created. Small business owners with income below a certain threshold can opt for the SIMPLES national system. Both SIMPLES and MEI provide access to pension benefits through contributions proportional to the minimum wage.

In Uruguay, the system was established in 2001 exclusively for street vendors. However, starting in 2007, its coverage was expanded to include low-income sectors, small business owners, and independent workers. In 2011, the Unique Tax Social MIDES was created for individuals in vulnerable social situations. The number of companies under the unique tax scheme grew significantly between 2006 and 2015, from 2,566 to 25,046 companies.

Therefore, international experience clearly shows that simplifying registration and tax collection favors increased social security coverage. Furthermore, greater flexibility in financing mechanisms can help formalize the informal economy.

### 3.2 “Sachet” strategy

In the 1970s, some brands in India introduced a “sachet” strategy, selling essential personal care products, such as shampoo, in daily doses. This approach allowed them to sell their products to lower-income segments, who otherwise would not have been able to access them.

This example highlights the importance of designing social security-related products tailored to the needs and capacities of workers. It is crucial to understand that informal workers often face significant liquidity constraints and highly volatile incomes, making it difficult for them to contribute under a traditional scheme that requires a fixed percentage of their income every month. For this reason, applying a “sachet” strategy that offers greater flexibility in the frequency and amounts of contributions is essential to ensure their participation in social security.

Another challenge informal workers face is the need to self-enroll in order to contribute, as they do not have a work contract or an employer to register them. Therefore, the social security enrollment process should be simple or even automatic, leveraging available electronic tools and designing strategies that facilitate contribution payments.

An example of this type of strategy is the Periodic Economic Benefits (BEPS) programme introduced in Colombia in 2015. It is a flexible and voluntary scheme for old-age protection aimed at workers who cannot make mandatory contributions, either because they work informally or because their income is below the minimum monthly wage. Under this scheme, workers can save for their retirement with whatever amounts they can afford, whenever they can, while the government rewards their efforts by providing a proportional subsidy, with an annual cap of USD 368. Enrollment in the programme is conducted electronically. According to data presented by Velásquez and Castillo (2024), by 2022, the programme had successfully enrolled a total of 1.8 million workers, while 44,000 individuals were receiving annuities financed through the programme.

### 3.3 Collection through patents or service invoices

In the region, there is also a significant group of workers who are informal in terms of social security but are formalized for tax purposes. In other words, they pay some form of tax (such as sales tax, professional service fees, or patent fees) but do not contribute to social security. For this group of workers, it is important to withhold an additional percentage from their tax or patent payments to cover (at least partially) their social security contributions.

An example of this measure is the requirement introduced in Chile in 2019, mandating that all independent workers who issue professional service invoices must contribute to social security. This allows such workers to access all social security benefits and enjoy the same protections as dependent workers.

At the time of implementation, workers were allowed to choose between full or partial coverage. In both cases, the contribution rate was set to increase gradually, reaching 17% by 2028. Additionally, the taxable base for calculating contributions is 80% of each worker’s gross annual income (from the previous calendar year), with the Internal Revenue Service responsible for determining and withholding the contributions of independent workers.

As shown in Table No. 1, during the 2023 tax year, a total of 613,367 independent workers were required to contribute. Of these, the vast majority (77%) opted for partial coverage under the different social security regimes, and the gender distribution was equal (50% men and 50% women).

**Table N° 1. Chile: Independent Workers Subject to Mandatory Contributions**

| Tax year (TY) | N° | Coverage | | Gender | |
|---|---|---|---|---|---|
| | | Total | Partial | Women | Men |
| **2019** | 528,779 | 14% | 86% | 48% | 52% |
| **2020** | 553,572 | 15% | 85% | 48% | 52% |
| **2021** | 519,477 | 20% | 80% | 49% | 51% |
| **2022** | 625,419 | 22% | 78% | 50% | 50% |
| **2023** | 613,367 | 23% | 77% | 50% | 50% |

**Source:** Superintendency of Pensions of Chile.

In Chile, Law 21,553 was also approved in April 2023, known as the "Uber Law", which regulates the services of passenger transport applications, such as Uber, Didi, Cabify, among others. This law was born out of the need to guarantee the safety of users, regulate the working conditions of drivers and ensure fair competition in the transport market. With this, the workers of these platforms are formalized, since as of February 2024, application companies must issue honorarium receipts for the income of each of their drivers, being obliged to contribute to social security like the rest of the independent workers who issue professional honorarium receipts. This seeks to integrate driver partners into the Social Protection regimes with the same coverage as dependent workers.

### 3.4 Contributions through consumption

One of the proposals that has emerged in discussions about new collection mechanisms is the so-called "pensions through consumption" (Save as you Buy). This approach involves collecting pension contributions through consumer spending. There are two possible mechanisms to implement this system:

The first mechanism (with fiscal cost) involves the government refunding a portion of consumption taxes (such as value-added tax or sales tax) to the worker's pension savings account. Currently, two countries in the region have incorporated legislative changes that include this mechanism. Since the government refunds these resources from its tax revenues, this mechanism incurs a fiscal cost.

- In Peru, the pension system modernization law, passed in September 2024, establishes an annual refund of 1% of individuals' expenses to increase their pension funds, with a consumption cap of 8 UIT (USD 10,962) per year.

- In Uruguay, to encourage electronic payments, legislation implemented "pension savings through consumption," where two percentage points of the consumption tax can be directed to pension funds, provided the payment method used is electronic.

The second mechanism (without fiscal cost) consists of collecting pension contributions through purchases made by individuals. When making a purchase, the consumer can request that a percentage of the purchase value or a fixed amount be allocated to their pension account. This mechanism relies on mobile applications that encourage savings using behavioral economics principles, such as rounding up daily purchases to save the leftover amount or incorporating gamified elements like challenges or reward systems. Platforms of this type are already in operation in several countries:

- In Mexico, the app *Millas para el Retiro* allows workers to contribute to their retirement savings through part of their monthly spending made with credit or debit cards.

- In Chile, the app *U-zave* enables individuals to save based on their consumption at certain associated stores, also offering the possibility to withdraw accumulated balances.

- In Spain, the app *Pensumo* allows users to accumulate a percentage of their purchases into personal savings accounts, although early withdrawals are penalized with a deduction of up to 20% if made within five years.

- In China (Inner Mongolia), the apps *Panchumo*, *Dejin*, and *Consumer Pension App* enable contributions through consumption at associated retailers.

### 3.5 Strategies from behavioral economics

Behavioral economics offers important tools to facilitate people's decisions to join or contribute to a social security scheme, addressing psychological barriers such as lack of attention or procrastination. A key tool is behavioral nudges, which are subtle interventions or strategies designed to encourage people to save for retirement.

For example, using timely messages to remind and encourage people to save is a cost-effective method. This requires adequate communication channels and the design of appropriate messages to promote the desired behavioral change. In Mexico, a large-scale pilot experiment involving message delivery through the *AforeMóvil* app resulted in a 16% increase in accumulated savings after nine months. Similarly, a behavioral stimulus pilot with BEPS affiliates in Colombia encouraged non-savers to start saving and active savers to save more through an SMS campaign coordinated with the Inter-American Development Bank (IDB). After 15 months, BEPS affiliates who had not saved before the intervention saved 14% or 12.4% more than the control group, depending on whether they received the SMS for 10 or 15 months.

Another effective alternative for incorporating informal workers into social security is to automatically enroll all individuals in the pension system when they reach adulthood. This allows individuals to become familiar with and aware of their savings account, which is particularly useful when combined with mechanisms like contributions through consumption. Peru's pension system modernization law includes automatic enrollment into the pension system for all individuals starting at age 18, which, as mentioned in the previous section, is combined with the new consumption-based contribution mechanism.

### 3.6 Informational campaigns and the use of social media

The lack of pension education leads many informal workers to undervalue the benefits of social security. Therefore, to encourage their incorporation, it is crucial to have strong informational campaigns that leverage social media as a mass communication tool to explain, in simple terms, the importance of protecting against various risks.

A successful example of the use of information campaigns is found in Ghana, a country with 80% informal employment. Through a strong advertising investment, the government launched the Self-Employment Enrollment Drive (SEED) as an initiative that focuses on enrolling self-employed workers and informal sector workers in the public social security programme (Social Security and National Insurance Trust - SSNIT) so that they contribute regularly. This programme offers coverage against illness, old age and death. It works as a collective savings fund, with benefits defined according to the number of years contributed to the system. The campaign has been extremely successful. According to figures published on its website, between 2022 and 2023 the programme managed to increase participation from 14,000 to 39,000 workers.

### 3.7 "SeLFIES" (Standard of Living Indexed Forward Income Securities) or Retirement Bonds

For informal workers who do not make mandatory contributions to finance their pensions, voluntary savings become essential. This requires individuals to take on greater responsibility for their retirement, which involves tackling complex financial decisions, such as determining how much to save, choosing how to invest their resources, and managing asset decumulation at the time of retirement.

SeLFIES bonds offer an easy, quick, and efficient solution to these challenges. These bonds are unique instruments that are liquid, low-cost, low-risk, and easy to understand. To address the issue of limited financial literacy, SeLFIES only require basic information that anyone can provide. Investors only need to know their desired future income value and the current value of the bond to determine how many bonds they need to purchase.

The case of Brazil is an example of success in implementing SeLFIES bonds. In January 2023, Brazil's Treasury launched *RendA+* (a modified version of the original academic proposal[3] for SeLFIES bonds), which pays investors in 240 installments and has payments linked to the IPCA (Broad Consumer Price Index). The instrument is based solely on its market value and does not include subsidies.

The initial results of the RendA+ issues were very positive. Figures from the first week of sales, between January 30 and February 2, 2023, show that RendA+ accounted for 60 million reais (USD 9.9 million) for 7,675 individuals. Additionally, Table N°2 indicates that RendA+ 2065, targeted at younger investors, represents 4% of the investors and 10% of the invested amount. This is a very encouraging sign that young investors see value in the instrument.

**Table N° 2. Brazil RendA+: Percentage of Investors and Assets for each Issue, January 30 – March 1, 2023[4]**

| RendA+ Conversion Date | % Investors | % Amount Invested | Median Investment (R$) |
|---|---|---|---|
| 2030 | 29% | 39% | 296 |
| 2035 | 21% | 18% | 471 |
| 2040 | 16% | 13% | 465 |
| 2045 | 15% | 12% | 469 |
| 2050 | 8% | 4% | 309 |
| 2055 | 5% | 3% | 277 |
| 2060 | 3% | 1% | 189 |
| 2065 | 4% | 10% | 197 |
| Total | 100% | 100% | |

**Source:** National Treasury of Brazil.

[3] The original proposal was put forward by Merton and Muralidhar (2020): *SeLFIES: A New Pension Bond and Currency for Retirement.*
[4] Exchange rate used: 6.06 reais per dollar (as of 09-12-2024).

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Queries: International Federation of Pension Fund Administrators (FIAP).
Address: Avenida Nueva Providencia 2155, Torre B, piso 8, Of.810-811, Providencia. Santiago – Chile
Phone: (56-2) 2381 1723; E-mail: fiap@fiap.cl; Website: www.fiapinternacional.org