

**Common Problems of Back Door Neighbors:
Social Security and Informal Employment in
Barbados, Trinidad/Tobago and Venezuela**

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Executive Summary
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Objectives

Over the past three decades, a large amount of literature has been devoted to studying the causes of informal employment. The most recent studies –those of Maloney (2001), Lora and Olivera (1998), Márquez and Pagés (1998) and Loayza (1997), for example— are in agreement that the term informal employment encompasses different kinds of workers, some of whom are forced to work in this sector, while others choose those jobs voluntarily. The causes of informality are many and range from imperfections in existing legislation and segmentation of the labor markets to macroeconomic adjustment programs and globalization. Some see in informality a mechanism for escaping unemployment, while for others it generates a spirit of entrepreneurship. Nonetheless, many other authors point out that informality is closely tied in with low productivity, poverty and a lack of social protection.

In this connection, one of the main challenges facing social security and assistance in the countries of the region is to extend the coverage of those benefits to the informal workers who, by their very definition, despite being those most exposed to poverty and unstable incomes, enjoy no social protection. Authors Burgess and Stern (1991), Holzman, Packard and Cuesta (2001) and the ILO (2001), however, point out that the very design of many social security systems in Third World countries hampers coverage of the majority of the workers.

Based on this theoretical framework, the study has two objectives:

1. To evaluate the degree of poverty and lack of social protection of informal workers in three of the region's countries: Barbados, Trinidad and Tobago, and Venezuela.
2. To recommend mechanisms for broadening social security and assistance coverage of informal workers in the selected countries.

Countries under study and data sources

Informal employment accounts for a sizable –and in some countries, growing— percentage of total employment in Latin America and the Caribbean. Venezuela is one of the region's countries to have experienced among the most rapid and noteworthy growth in informal employment. ECLA findings reveal a rise in informal employment from 34.2% in 1990 to 48% in 1998. Most of the Caribbean countries, as compared with those of Latin America, reveal low and stable levels of informality. In Barbados, for example, ILO figures show informal employment to have been in the neighborhood of 15% of total employment over the nineties, while in Trinidad and Tobago that figure declined from 22.4% in 1993 to 19.4% in 1999.¹

¹ The region's countries do not apply definitions of informal employment that are homogeneous and for that reason the comparison of the figures is not perfect. Nevertheless, the trends and levels recorded reveal the existence of sizable differences among the countries.

These differences in pattern, as well as the disparity in living standards and in levels of institutional development, stand in sharp contrast to the fact that the three countries have the same type of social security system. All three are public distributional systems with partial capitalization and defined benefits. All three have been in operation in their present form for about 40 years and thus are in a stage of maturation. The three countries all maintain a universal cost-free medical service system financed from general taxes and supplemented by private services and insurance plans. The results as to the worker's social protection, however, could not be greater. Social security coverage ranges, in effect, from 22% (Venezuela) to 75% (Barbados) of the economically active population. The marked differences between them makes this an interesting group of countries to compare.

We used several sources of information to study the causes of results that vary so sharply despite the use of a single social security system of organization. First, we drew on the three countries' Social Security management reports (*Memoria y Cuenta del Instituto Venezolano de Seguros Sociales, Annual Report of the National Insurance Scheme in Barbados* and *Annual Report of the National Insurance Board in Trinidad/Tobago*). Secondary sources of information included the annual statistics published by the Central Bank of Barbados, the Central Statistical Office in Trinidad/Tobago and Venezuela's National Statistical Institute. In the case of Venezuela, we also had access to primary data taken from the Sample Household Survey covering several years during the nineteen nineties, while in that of Barbados, we studied the tabulated results of the Informal Sector Survey prepared by the Statistical Service Department between 1997 and 1998.

Methodology

First, the social security systems in operation in each of the countries in question were reviewed. The legal system in effect was described, together with the results in terms of the balance of the management, coverage and amount of protection offered by each system. Then the concept of informal employment as used in each country was discussed and an economic profile of the informal workers prepared. This revealed the distinguishing features of the sector and helped uncover the differences and similarities among the countries. During this stage, the effect of informal employment on the level of poverty of workers in Barbados, Trinidad/Tobago and Venezuela was assessed, thus establishing the relationship between informal employment, poverty and social security coverage. When microdata were available (as in the case of Venezuela), a categorical variables model was used that associated the levels of poverty with informal employment, thus enabling us to establish the conditional probability of living in poverty if working in the informal sector. When access was limited to aggregate data, we merely described the non-conditional probabilities of informal workers' living in poverty.

Finally, after evaluating the performance of each social security system and its relationship with the informal sector, the causes of coverage problems in each country were explained. The pertinent policy recommendations emerged from this diagnosis.

Main Results

The key finding of this study is that countries with a similarly-designed social security system show glaringly different levels of social protection of the working population. As a result, the reforms that should be introduced in order to improve the operation and coverage of the system should not be based exclusively on an identification of its structure, but on the causes for its malfunctioning.

All three countries effectively have a distributional public social security system with partial capitalization and defined contributions. The contribution rates range from 14 to 16% of income and the pensions represent between 40 and 60% of the reference income for the three countries. All three are systems that are entering upon their maturity after almost forty years of operation with the existing structure. Furthermore, medical care is universal and free, being financed from general taxes in the three countries (although in Venezuela, part of the medical care is reserved for workers who contribute to the social security system).

Despite their similarities as to organization and design, the three systems produce results that differ widely. In Barbados, the social security system runs a surplus and covers three-quarters of the labor force, while public spending on health represents 4% of GDP. In Trinidad and Tobago, the social security system has been showing a surplus since the reform of the contribution rates in 1999, but its coverage extends to only one-half of the labor force and public health spending amounts to 2.5% of GDP. In Venezuela, for its part, the social security system has been running a deficit over the past two decades and covers only 22% of the labor force, while only 2% of GDP goes to fund public health expenses.

Two basic causes are responsible for the glaring differences among the countries under study: in the first place, the size of the informal sector in each economy, and in the second, the effectiveness of public management in general and of the administration of the social protection system in particular.

In Barbados and Trinidad/Tobago, the informal sector is small (between 6 and 20%, depending upon the definition of informal employment that is used), while in Venezuela, it is enormous (between 50 and 70%, again according to the definition). Downes, Mamingi and Belle (2000) and Betancourt, Greije and Márquez (1995) explain the causes of this difference. Venezuela has been suffering economic stagnation for the past two decades and its labor legislation shows little flexibility. Barbados and Trinidad/Tobago, on the other hand, emerged from a severe recession in the late eighties and early nineties to proceed to high growth rates starting in the mid nineties. Furthermore, the labor legislation of these two countries has little effect on the creation of jobs.

It is interesting to note that while there are differences among the countries as to the size of the sector, the distinguishing characteristics of the informal worker are the same: little schooling, higher average age, smaller average earnings and concentration in the agricultural and commercial sectors. Furthermore, informal employment shows a greater

degree of poverty and enjoys less social security coverage. Informal workers, however, do not represent the majority of the poor, implying that a sizeable group of formal workers live in poverty also. In addition, most of the workers who are not affiliated with the Social Security system are not necessarily informal (40% in Barbados and 50% in Trinidad/Tobago and 70% in Venezuela), showing that the problem of extending the coverage is not limited to the informal sector.

Obviously, the higher the percentage of informal employment in the labor market, the greater the system's problems of coverage because informal workers, by definition or by incentive, are less likely to join the social security system. However, as we pointed out in the previous paragraph, the formal sector of the economy also suffers from inadequate coverage. The lower the coverage among active workers, the more difficult it will be for the system to benefit from economies of scale. The end result will be higher administrative costs for the system, less efficient risk distribution and less equitable income distribution. In short, low coverage makes it difficult for the social security system to fulfill its mission.

The effectiveness of the administrators' management is another important cause for the differences in results among the countries under study. While coverage in Barbados is not as complete as that of the European countries, its system is still solvent. Trinidad/Tobago, or Venezuela in the seventies, covers only one-half of the active population, but the system is not unviable. In all of these cases, responsible management should be capable of making good use of the accumulated contributions (the system's partial capitalization), controlling administrative expenses and introducing changes in parameter as to the numbers and sizes of the contributions, if necessary, to keep the system from becoming insolvent. Barbados and Trinidad/Tobago have taken steps in this direction and expect to attain financial solvency in the medium term, but Venezuela does not. For a period of two decades, the latter country drew upon pension funds to cover medical care expenses and to invest in state securities that produced negative yields during periods of high inflation. After making some timid changes in parameters in the early nineties and following an aborted structural reform proposal at the end of that decade, Venezuela's social security system today shows a serious deterioration in quality and is financially unviable.

When the administrative capacity of social security management fails, workers lose confidence in the system. Their interest in paying their contributions flags and problems of coverage worsen, extending beyond the informal system. Furthermore, administrative reforms prove to be ineffective because of a lack of competent personnel who cannot be believed because the public does not trust the institution.

The conclusion to be reached from the above is that the measures for extending social security coverage to informal workers, and to those in the formal sector, depend upon the magnitude and the causes of the problem.

Policy Implications

Given the glaringly different causes of social security coverage problems among the countries under study, the recommendations must also vary. In the case of Barbados, where the informal sector is small and public management enjoys the people's trust, the recommendations for broadening that coverage are basically administrative in nature. In the case of Venezuela, on the other hand, where informality is the rule and people do not trust the social security administration, more far-reaching reforms are needed. Trinidad/Tobago enjoys an intermediate position between the two and for that reason should insist upon growth policies in order to cut down on informal employment, together with administrative policies to extend coverage.

In Barbados, the key problems to be met by the social security system are:

1. to broaden its coverage among both formal and informal workers and
2. to increase the benefits available to poor workers.

The policy to be adopted for extending coverage should take into account the fact that two types of workers have no protection. On the one hand, there are the informal workers whose distinguishing characteristics are little schooling, low productivity and unstable earnings, and on the other, formal workers who, on average, have more schooling, are more productive (a fact associated with a greater incorporation of capital) and stable incomes. As a result, the policy for broadening social security coverage should have a two-fold approach:

- 1.1 For informal workers, to launch an NIS affiliation campaign in a social undertaking that would incorporate the following elements:
 - 1.1.1 Advertising and dissemination of information
 - 1.1.2 Workshops and community or trade organization programs
 - 1.1.3 Promotion of the creation of non-governmental organizations and/or cooperatives that will offer social protection programs
- 1.2 For formal workers without coverage, a choice should be made between two alternative courses:
 - 1.2.1 Not adopting specific coverage policies, under the assumption that a portion of the workers not covered by the NIS and who work in the formal economy have some private insurance protection.
 - 1.2.2 Increasing the supervision and penalization of enterprises and individuals who fail to pay their contributions to the social security system.

In the case of increasing benefits for workers who, while covered under the NIS, live in poverty, it should be recognized that when income levels are low, the benefits are meager. In that connection, the policy to be followed should be aimed at increasing the workers' productivity. This can be attained only in the medium or long term through policies

designed to enhance the education and training of the active population, on the one hand, and maintain macroeconomic stability in order to encourage capital investment by working unit, on the other.

These recommendations will help broaden social security coverage and build up the sufficiency of its monetary benefits. As for the medical services, the coverage is guaranteed because access to the system is universal and non-restricted. Nonetheless, it is a recognized fact that medical care in Barbados suffers the delays and rationing typical of systems of that kind. An increase in the central government's allocation to the social security system is necessary, if the provision of medical care is to be speeded up and the system's quality improved, given its existing operational structure. There are three possible options for increasing spending on health care, however: boosting tax collections, increasing the fiscal deficit (and the search for additional financing for that deficit) and reducing budgetary allocations for other items. While all of these options are difficult to implement, multilateral organizations can contribute to the financing of additional expenses in order to improve medical care in three areas:

1. Financing for investment in new medical equipment and facilities;
2. Financing for public health programs and disease prevention (the island is particularly concerned over diabetes and AIDS); and
3. Financing for the education and training of more medical and paramedical personnel.

The general policy recommendations for Trinidad/Tobago have a two-fold thrust: to reduce the gap between number of wage earners and salaried workers and number of social security contributors and to encourage self-employed workers to participate. In the former cases, the recommendations are as follows:

- a. To upgrade the system's administrative capacity. It is essential to improve both internal and external controls in order to keep updated records of possible contributors. At the same time, penalties should be designed and instituted that are believable and sufficiently strong to be applied to workers and employers in the formal system.
- b. Worker information programs. Information campaigns in the different communications media are recommended, targeting workers and employers in the formal system.

In the latter case –promoting the participation of self-employed workers--, the following measures are recommended:

- a. Voluntary coverage combined with public subsidies. An option that is viable for encouraging the participation of self-employed workers, particularly those who do not have enough funds to cover the pertinent payments, is to provide for shared participation between workers and state. This policy can be refined as data are collected on the average income of the different groups of self-employed workers. In this connection, different degrees of participation between the state and worker could be established, based on the income levels of the different groups.

- b. Flexible programs. One of the hallmarks of self-employed workers is the irregularity of their income. For that reason, a system that is intended to extend the coverage to these workers should allow for sole contributions or installments that are scheduled for payment at given times of the year because it is unlikely that a worker with these characteristics could make constant value monthly payments.
- c. Worker information programs. Another measure that is essential if coverage is to be extended to self-employed workers, is the launching of information campaigns that will publicize the benefits of the system, together with the different ways to join it.

In Venezuela, five years of attempted reforms met with failure because Venezuelan society could not reach an agreement on the kind of reform that was desired and attainable. The dilemma lies in the fact that in view of the high levels of poverty and lack of social protection, there are those who propose the establishment of systems to guarantee free state social assistance for the poor population and those lacking in social protection. Others, however, insist that transfers of this kind are unviable because the state does not have the necessary resources for that purpose and that, therefore, the reform should rest on individualized contributions from the workers.

The recommended reforms must, therefore, deal with both problems. In that connection, the social security system must be submitted to a structural reform under the following guidelines:

1. A structural reform must be undertaken with regard to pension insurance and monetary health and unemployment benefits, consisting of the following:
 - i. The creation of a new social security institution that would collect compulsory contributions from workers and employers to finance a solidary fund covering minimum pensions and monetary benefits for accidents/maternity/health and unemployment;
 - ii. The establishment of individually capitalized public and private funds that would collect compulsory contributions from workers and employers to finance pensions that would supplement the minimum pensions provided by the solidary fund;
 - iii. The establishment of optional insurance savings accounts in the financial system that would enjoy fiscal incentives; and
 - iv. Making participation in the new system compulsory for all new workers and optional for members of the previous system who meet certain conditions (mainly low age and small number of contributions made).
2. In the case of social assistance for aged persons who have not contributed, a non-contributive pension could be introduced, amounting to no more than 50% of the minimum wage and applicable on the basis of an examination of their resources.
3. In the area of medical care, the reform should introduce the following measures:
 - i. Unification of medical services under a single governing and supervisory unit;

- ii. Decentralization of the management of medical care services at the level of regional and local governments in order to improve service quality by moving closer to the user;
- iii. Financing of medical care through general taxes and by increasing the allocation for health expenses;
- iv. Maintenance of the private healthcare and insurance services, without tax exemption, in order to diversify the sources of service without impairing the financing of the public system.

All of these reforms are structural and are aimed at reorganizing Social Security management in Venezuela. Even so, it is quite possible that the reforms involving pension, health and unemployment insurance would continue to be plagued by problems of coverage so long as informal employment continues to account for the lion's share of Venezuela's labor market. Specific measures will be needed in that area to improve the coverage of informal workers, such as the following:

Establishment of mechanisms making it optional for informal workers to contribute to the insurance. These measures are:

- i. To establish optional contribution rates that are flexible in two aspects:
 - 1. The possibility of choosing the desired coverages (pensions, monetary health, accident, maternity and unemployment benefits), so that workers who have few resources can choose the insurance plan that is most useful to them, at a given cost;
 - 2. The possibility of choosing different payment periods, so that workers whose income is very irregular can join the system.
- ii. To launch an information campaign publicizing the benefits offered by the insurance system and the procedures for joining and contributing to it.
- iii. To establish a positive image for the new institution by administering its funds transparently.
- iv. To promote the creation of not-for-profit organizations that would offer medical care, work accident and maternity insurance services to organized groups of informal workers.

The proposed reform could cost between 4 and 10% of GDP annually. Today, the Venezuelan central government's total spending amounts to 22%. Obviously, it will not have enough resources available for that purpose unless a series of important fiscal reforms are carried out, including an increase in tax collections and privatizations and the refocusing of public spending.

Research agenda

Lack of coverage is a key problem in the social security systems of many Latin American countries. Further research is necessary into the different social security reform programs being carried out in the region, both those involving parameters and those focusing on structure, in order to identify which reforms have been successful in increasing coverage.

Another aspect calling for additional work is the standardization of the concept of informality, so that the problem can be more easily analyzed and compared among countries. Informal employment is a term that has been used in pertinent literature for thirty years, but an agreement on a precise definition has yet to be reached. Nor has an operational definition been obtained that would cover all of the region's countries and make it possible to evaluate the problem at the regional level.