

Sri Lanka's Experience with Informal Sector Pensions

**Social Protection in South Asia: Growth
with Equity, Security and Opportunity
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Outline

Country Background

Employment and Pensions

Informal Sector Pensions

Problems & Lessons





A Way Forward







Country Background

History

History and Politics

-  Universal suffrage - 1931
-  Plantation sector and nationalist aspirations
-  Two party competition 1950s
-  High tax base

Major Initiatives

-  Free education and health care - 1930s
-  Food rations - 1940s
-  Social Insurance Commission - 1948
-  Provident Funds - 1950s

Current Situation

✿ Social protection

- ✿ High levels of coverage for health, education
- ✿ Significant income transfers to “poor”
- ✿ ~45% of workforce covered by formal old age income schemes

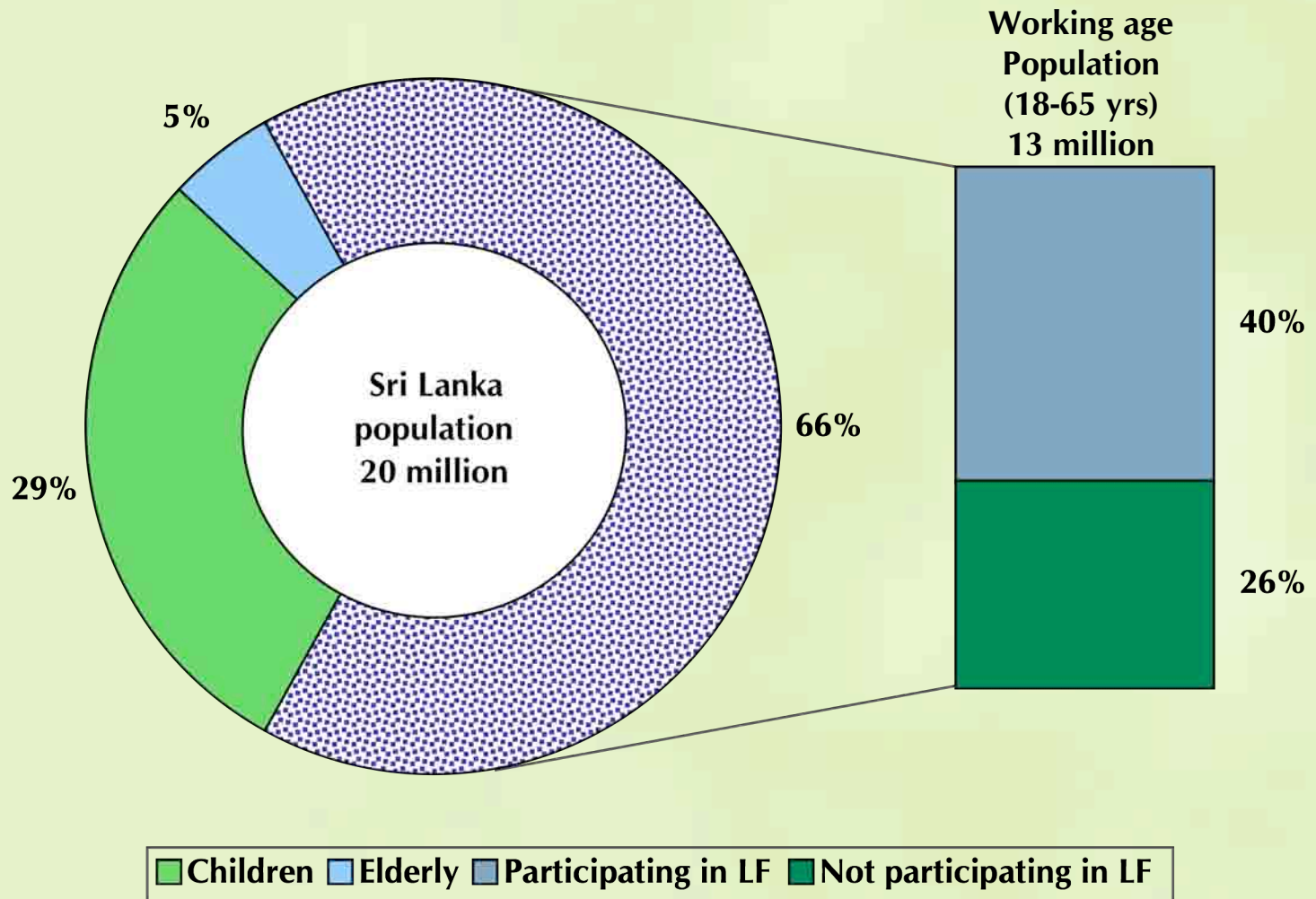
✿ Economic context

- ✿ GDP per capita ~ \$1,000
- ✿ Low tax base ~ 16% GDP
- ✿ Ageing population
 - ✿ Life expectancy 77 years by 2050
 - ✿ >60 years 16% of electorate (2006)
 - ✿ >60 years 36% of electorate (2050)



Employment & Pensions

Who's in work?



Formal Sector Schemes

✿ **Civil Servants Pensions**

- ✿ Defined benefit scheme
- ✿ Pension benefit (ad hoc inflation adjusted)
- ✿ Coverage ~ 8.5 lakhs

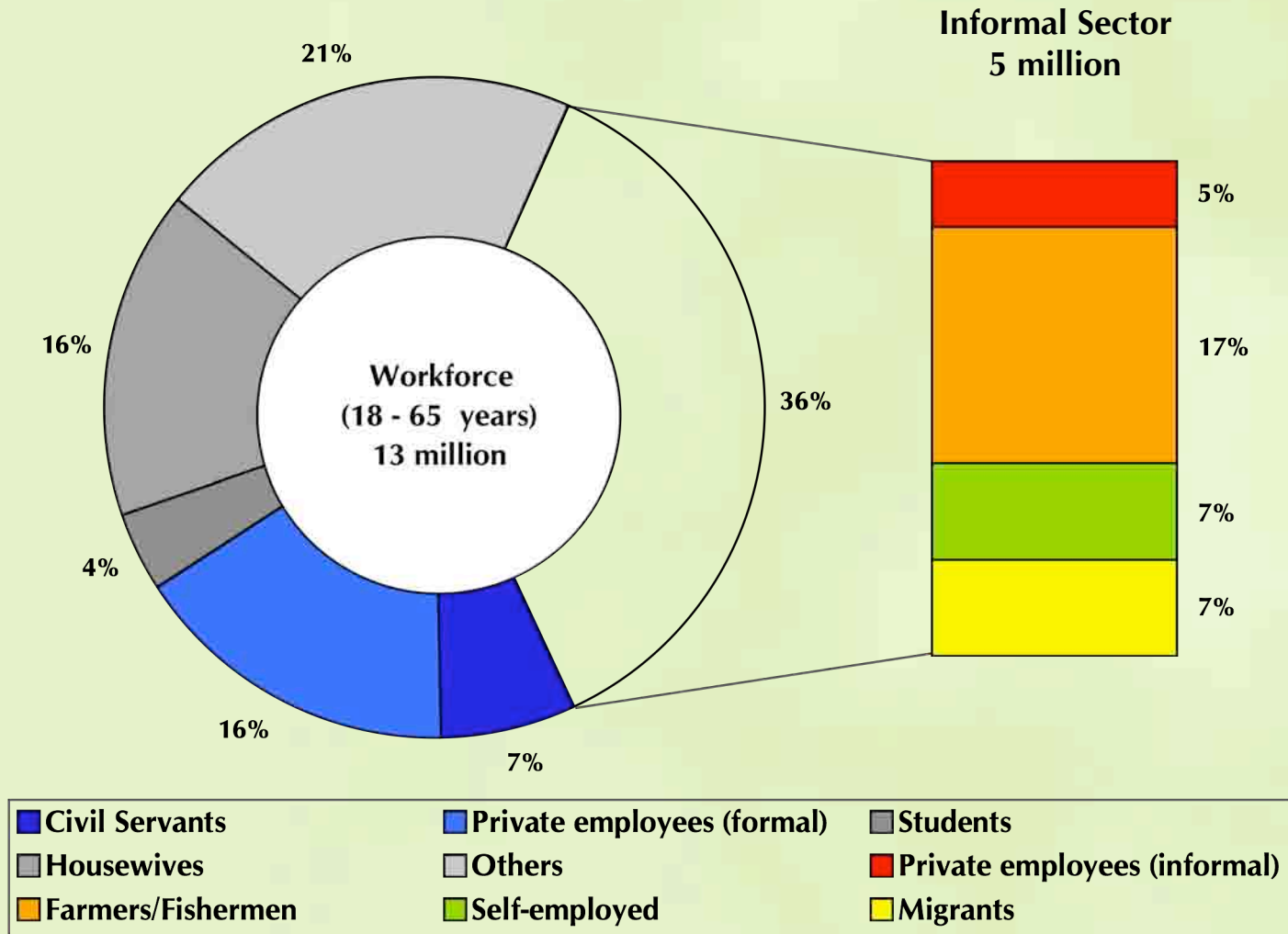
✿ **Provident Funds - EPF/ETF**

- ✿ Defined contribution schemes
- ✿ Savings account - no pension
- ✿ Coverage ~ 2 millions

✿ **Provident Funds - APPFs**

- ✿ Define contribution schemes
- ✿ Coverage ~ 2.5 lakhs

Informal Sector





Informal Sector Pensions

Responding to Informal Sector Workers (Voters)

✿ **Farmers**

- ✿ Farmers' Pension Scheme 1987

✿ **Fishermen**

- ✿ Fishermens' Pension Scheme 1990

✿ **Self-employed**

- ✿ Self-employed Pension Scheme 1996

✿ **Informal sector private employees**

- ✿ Efforts to enforce EPF collection
- ✿ Ad-hoc small schemes

✿ **Migrant workers**

- ✿ Little action
- ✿ . . . But no voting rights!

Farmers' Pension Scheme

- ✿ Farmers' Pension and Social Security Benefit Scheme Act, 1987
- ✿ Contributory pension scheme for farmers with Treasury contribution
- ✿ Administered by AAIB/Ministry of Agriculture
- ✿ Pension + social security benefits (death gratuities, disability benefits)

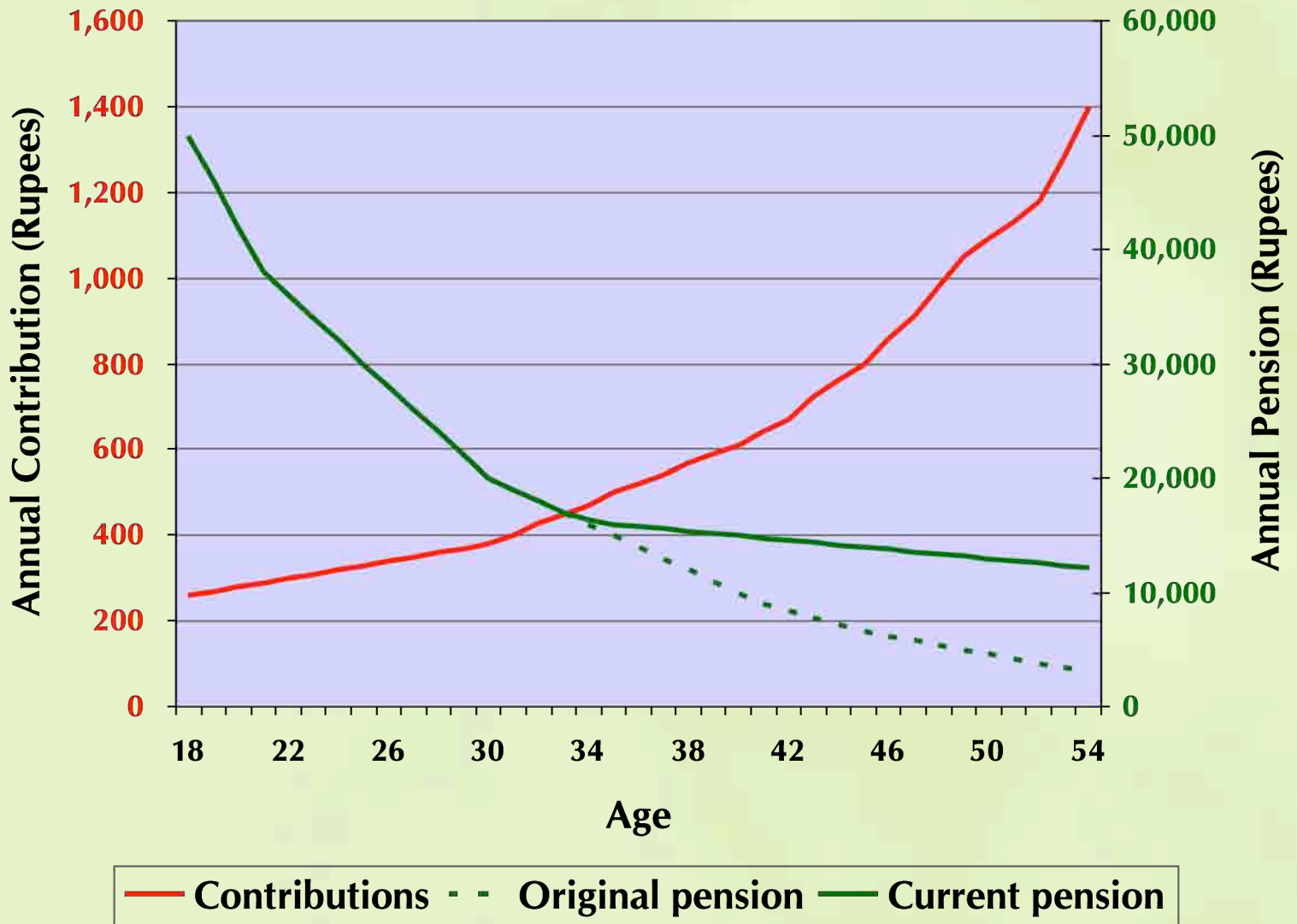
Fishermen' Pension Scheme

- ✿ Fishermens' Pension and Social Security Benefit Scheme Act, 1990
- ✿ Contributory pension scheme for farmers with Treasury contribution
- ✿ Administered by AAIB/Ministry of Fisheries-Fisheries Dept
- ✿ Pension + social security benefits (death gratuities, disability benefits)

Organization of Schemes

- ✿ **Enrolment - voluntary, if meeting eligibility criteria**
- ✿ **Fixed level contributions/pensions**
 - Farmers - 2/year
 - Fishermen - 4/year
- ✿ **Contribution collection decentralised - collection agents used. Individual records**
- ✿ **Contributions credited to pension and insurance funds -> govt debt/fixed deposits**

Contribution Schedules



Enrolment

✿ Farmers' Scheme

- ✿ 680,000 enrolees (57% coverage)
- ✿ Coverage higher in more developed provinces
- ✿ Enrolees younger than average
- ✿ Default rate ~30-40%??
 - ✿ ...But practice is to be forgiven by Cabinet

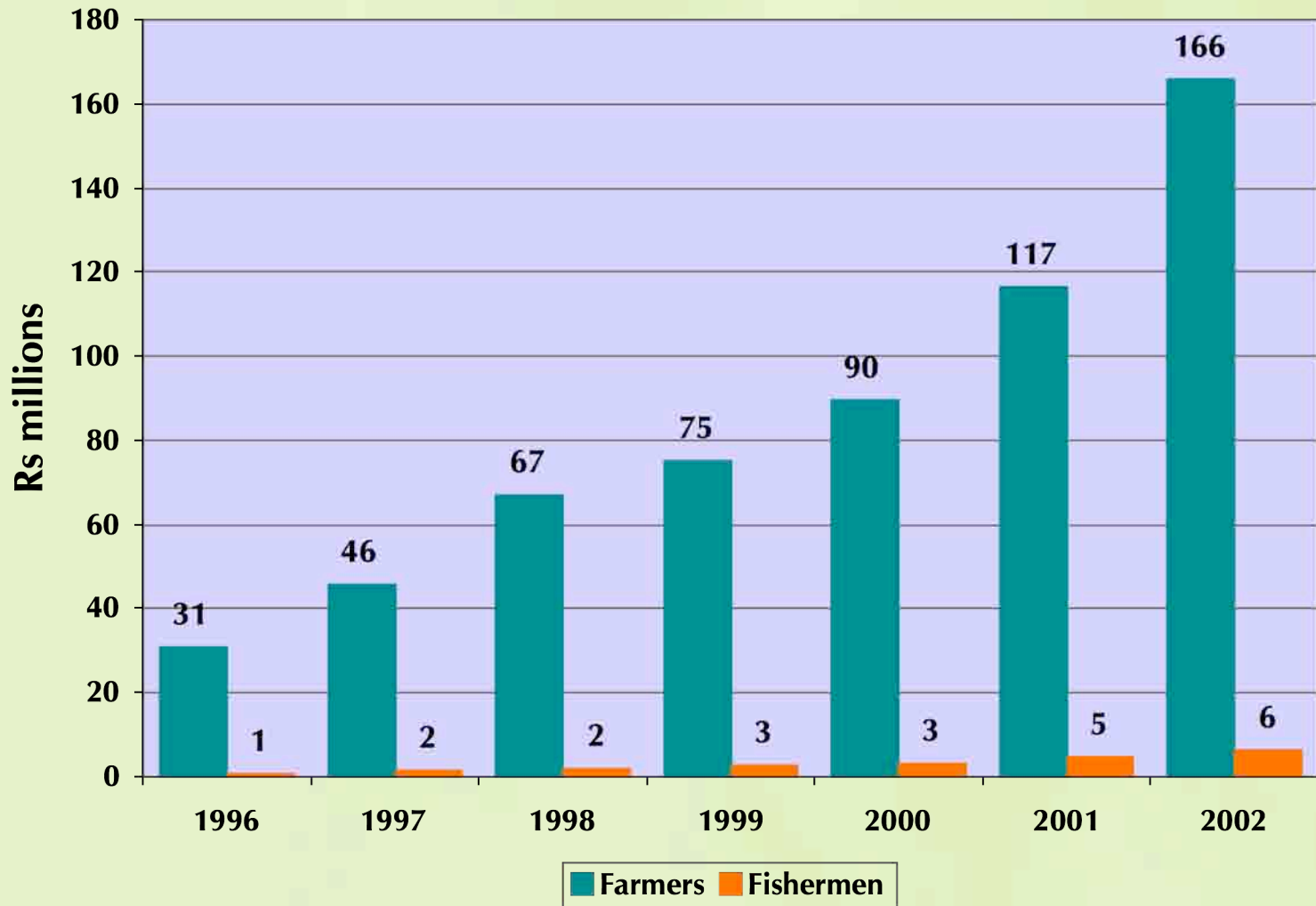
✿ Fishermen's Scheme

- ✿ 48,000 members (42% coverage)
- ✿ Default rate ~30-40%??
 - ✿ ...But practice is to be forgiven by Cabinet

Finances: Farmers' & Fishermens' Schemes

- ✱ **Financial record-keeping very poor**
- ✱ **Government contributions not honoured**
 - ✪ Farmers: Less than one fifth honoured by MoF
 - ✪ Fishermens: Partial coverage of admin costs
- ✱ **Annual income**
 - ✪ Farmers: Rs 300-400 million
 - ✪ Fishermens: Rs 40-50 million
 - ✪ Sources: 20-50% from interest/investments
- ✱ **Annual expenses million**
 - ✪ Farmers: Rs 250 million
 - ✪ Fishermens: Rs 10 million
- ✱ **Total fund assets**
 - ✪ Rs 2.5 billion + Rs 0.3 billion

Pension payments



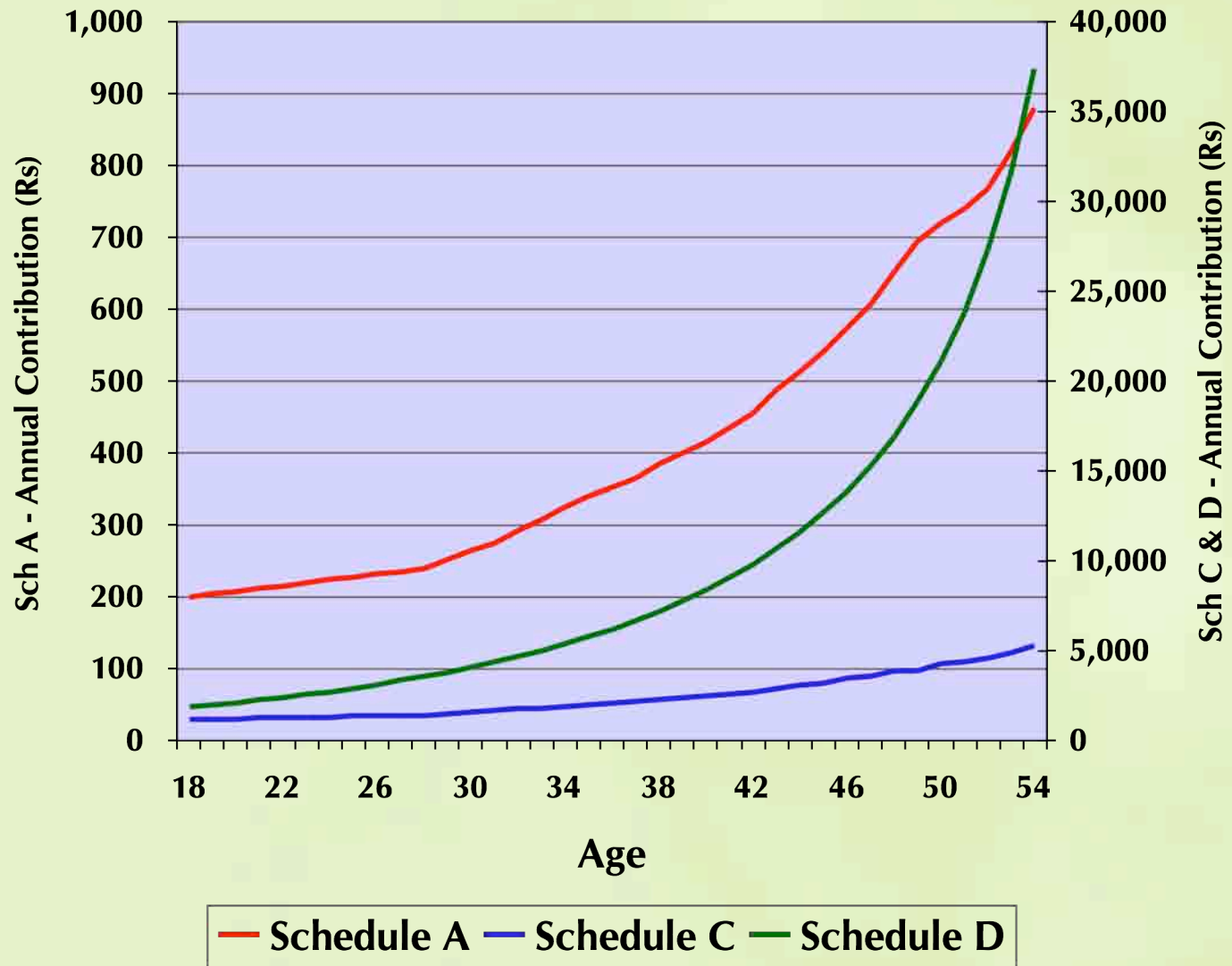
Self-employed Pension Scheme

- ✿ Pension and Social Security Benefit Scheme for Self-employed
- ✿ Social Security Board Act, 1996
- ✿ Contributory, partially subsidized, pension scheme for self-employed
- ✿ Administered by SSB/Ministry of Social Services
- ✿ Pension + social security benefits (death gratuities, disability benefits)

Organization of Scheme

- ✿ **Enrolment - voluntary, if meeting eligibility criteria (must be 18-59 years, income below tax limit)**
- ✿ **Fixed level contributions/pensions**
 - 4 payments/year (Schedule A)
 - 12 payments/year (Schedules C & D)
- ✿ **Contribution collection: Divisional Secretariats, Postal Departments, Agents**
- ✿ **Contributions -> govt debt/fixed deposits**

Contribution Schedules



Operational Performance

✿ **Enrolment**

- ✿ 65,000 members (<5% coverage) [mid-2002]
- ✿ Schedule A: 96%, Sch C: 3%, Sch D: 1%
- ✿ Annual enrolment declining after 1999
- ✿ Coverage higher in more developed provinces
- ✿ 50% female (compared with 20% in self-employed workforce)
- ✿ Default rate ~10-30% (??)

✿ **Financing**

- ✿ Full Treasury contribution not forthcoming

✿ **Expenses ~ Rs 3 million/y7r**

✿ **Administration relatively well-managed, but under-staffed**



Problems & Lessons

Issues

1. Administration inefficient

- ❖ Inefficient - high cost ratio, Lacks economies of scale, capacity

2. Deficient contribution design

- ❖ High default rate owing to fixed payment schedule
- ❖ No provision to change contributions for changed circumstances

3. Large unfunded costs

- ❖ Farmers/Fishermen > Rs 2-5 billion
- ❖ Self-employed > Rs 300 million

4. Insufficient incentives for voluntary enrolment

5. Not suited to growing economy

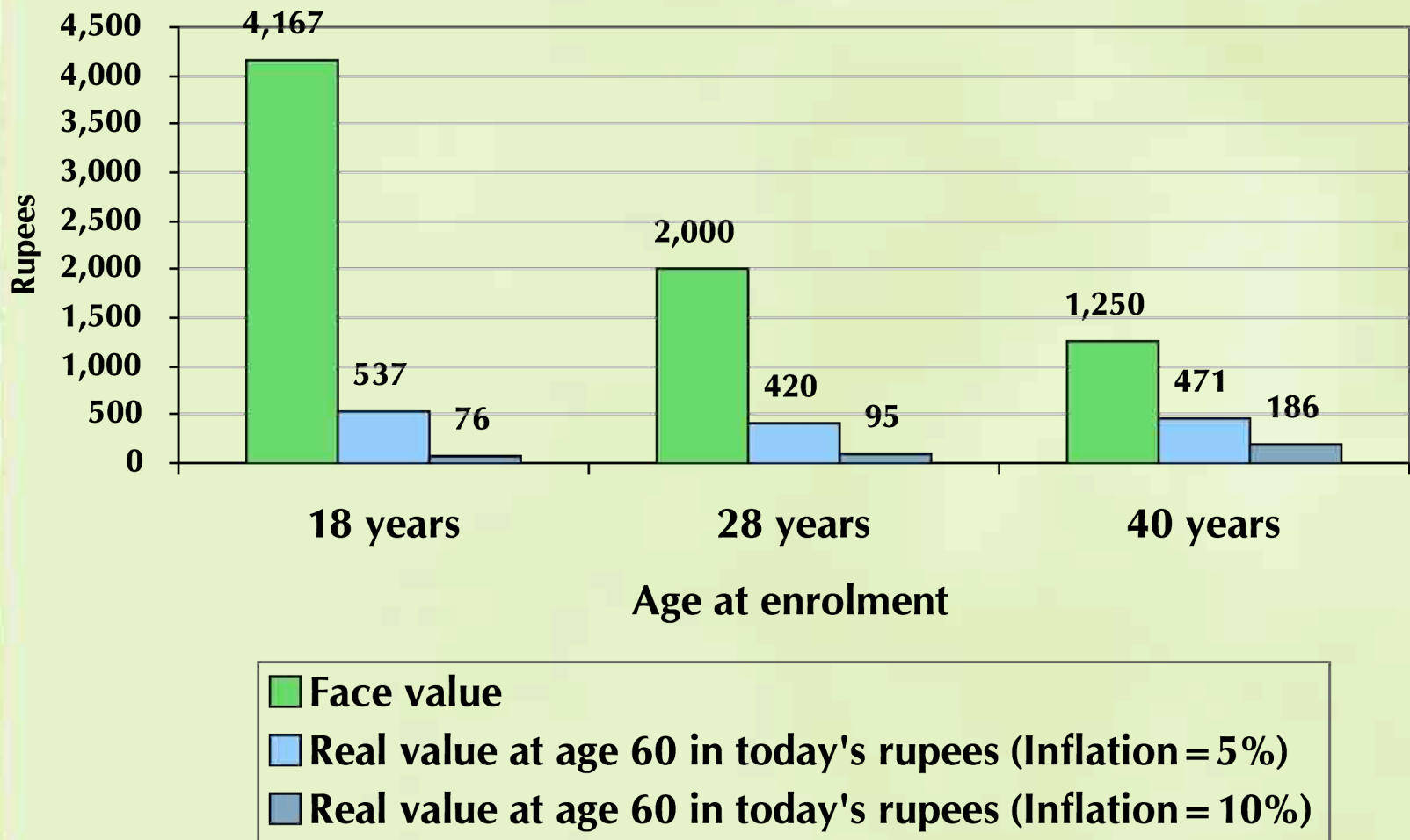
- ❖ Not designed for labour market flexibility/employment changes

6. Pensions will fail to prevent poverty

- ❖ No inflation protection

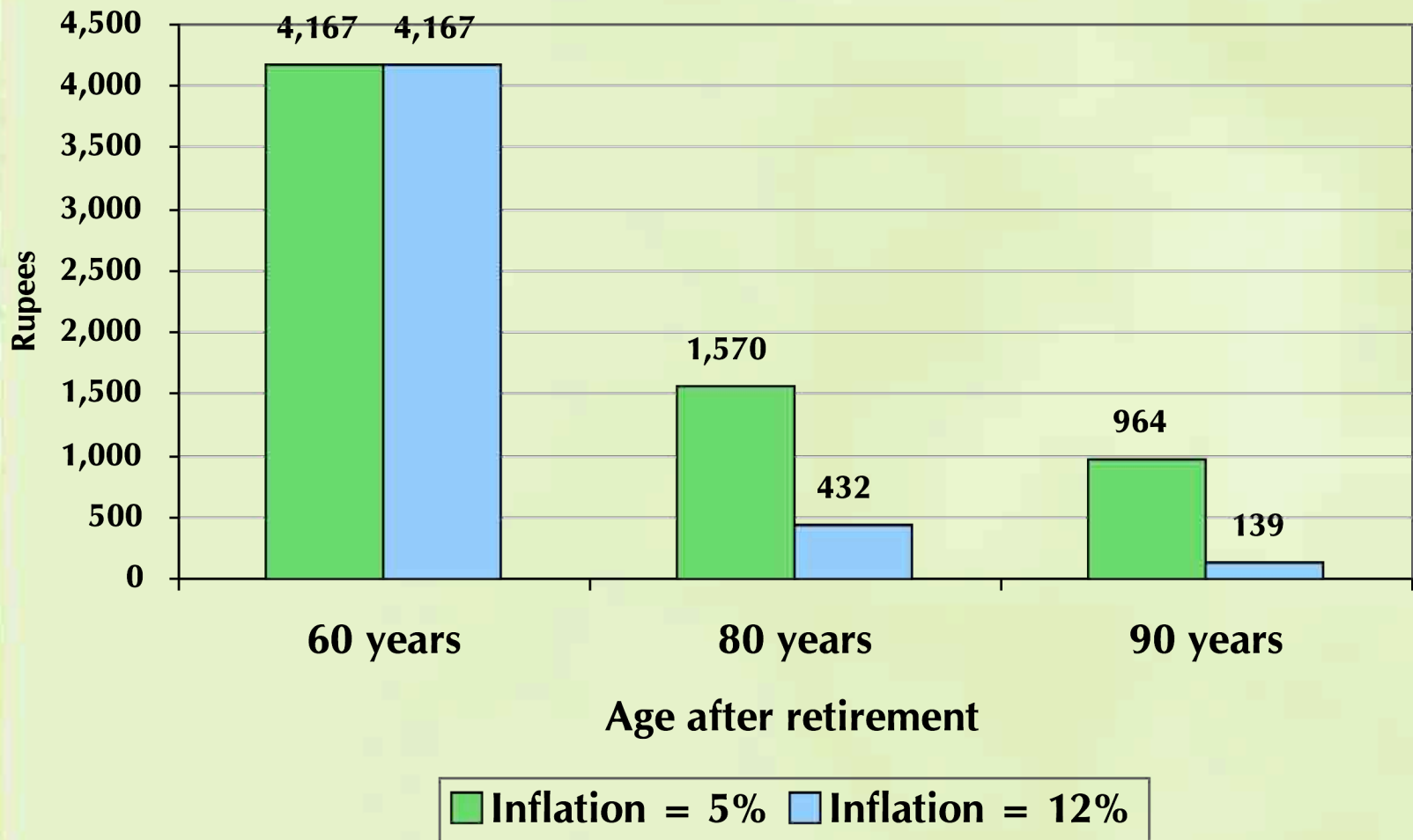
Pensioners will be poor

✿ Fixed pensions provide no protection against inflation



... and even poorer

✿ Fixed pensions will deteriorate during retirement



Political Response

✿ **Benefit adjustments**

- ✿ Ad-hoc increases in benefits with inflation by Cabinet decision, emphasizing increase in floor benefit

✿ **Contribution adjustments**

- ✿ Ad-hoc forgiveness of contribution defaults
- ✿ But no increase in contribution levels

✿ **Implicit increase in Treasury liabilities**

- ✿ Increasing gap in funding, but benefits guaranteed by statute --> Contingent fiscal liability

Recommendations (2002)

- ✿ **Improve management & technical capacity**
- ✿ **Pay administrative costs from Treasury**
- ✿ **Shift to inflation-indexed contributions and pensions**
- ✿ **Increase period of contributions beyond 60 years for higher pension**
- ✿ **Base pension on life-time contributions**


Lessons

- ✿ **Pension schemes are a political response to expected poverty/inadequate incomes**

- ✿ World Bank OED (2006)

- “ . . . preoccupation with fiscal sustainability [has] tended to obscure the broader goal of pension policy, that is, to reduce poverty and improve retirement income adequacy *within a fiscal constraint*.”

- ✿ **If a scheme, which was introduced as a political solution does not meet the primary goal, then it will be modified . . . To think otherwise is fiscally myopic**
- ✿ **Challenge is to design a scheme that meets poverty objectives as well as being fiscally sensible**



A Way Forward

A Better Approach

✿ **Contribution design**

- ✿ Should allow for flexibility in payments

✿ **Benefit design**

- ✿ Should be actuarially linked to contributions
- ✿ ... But recognize social preference to ensure minimum pension floor
- ✿ ... And political willingness to use tax money to pay for lowest wage workers

✿ **Fund management**

- ✿ Primary goal is fund security and gaining workers trust, not capital market development

“Coffee grinders”

✿ Numbers & coverage

- ✿ 200 - 500,000
- ✿ 75% in theory covered by EPF statutes, but mostly not owing to evasion, weak employment protection conditions, transient employment

✿ Financial constraints

- ✿ Hard manual labour - high disability rates, early retirement typical
- ✿ Wages 75% of average

✿ Career patterns

- ✿ Often not lifetime occupation - shift to farming or to formal sector when opportunity arises

✿ Political impact

- ✿ Not unionized, but sufficient political size to influence ministers

A Coffee Grinders Scheme

✿ Individual contributions

- ✿ Unique lifetime pension ID number
- ✿ Contributions to be credited to personal pension account
- ✿ Total flexibility in payments - can be made weekly, monthly, annually, at any time during life
- ✿ Employers can enroll in scheme and make employer contribution to scheme: Option to switch from EFP provided
- ✿ If worker changes employment, will retain account balances and linked pension benefits
- ✿ Collection agents - EPF system, banks, employers, post offices, govt departments
- ✿ Investment management fixed to EPF portfolio (mostly government securities)

A Coffee Grinders Scheme

✿ Individual benefits

- ✿ Account balances to be credited annually with investment return based on pension fund returns
- ✿ Pension to be guaranteed, inflation-adjusted monthly cash payment based on actuarially fair valuation of account balance at time of withdrawal
- ✿ Higher than inflation return to be paid based on regular actuarial evaluation of pension fund
- ✿ Pension formula will link pension to account balance with penalty for early withdrawal
- ✿ Low wage adjustment - pension formula will award higher pension for lower wage members with no other income
- ✿ Associated disability benefits

A Coffee Grinders Scheme

✿ **Political recognition that Coal Miners are too poor to afford adequate pension**

- ✿ Gap between likely pension based on contributions and poverty line to be met by tax contribution to pension fund
- ✿ But recognizing difficulty of general revenue subsidy

✿ **. . . Industry specific tax or cess**

- ✿ Set of industry-specific taxes to be used to mobilize funding
- ✿ Designed to be difficult to evade
- ✿ Employer rebate on cess, if workers enrolled in scheme
- ✿ Partial matching contribution by Treasury as incentive to worker and employer

A Coffee Grinders Scheme

✿ **Fiscal sustainability**

- ✿ Pension fund will be required to evaluate financial position annually and change benefit levels and credited investment returns
- ✿ Required tax subsidy less than with current Farmers scheme

✿ **Extensibility**

- ✿ Provision to be made to later permit contributions by coal miners who become migrant workers
- ✿ Coal miners who qualify to join scheme, can continue to contribute to scheme after changing employment

✿ **Precedents?**

- ✿ Cess-financed estate workers social services scheme
- ✿ US Social Security/Japan National Pension



Thank You