Social Protection for Informal Workers: Trends and Changes

Challenges and strategies to increase social protection financing for workers in informal employment

Introduction

In this briefing note we review the current debates about challenges and strategies to increase financing for social protection, which is essentially to enable the extension of coverage to informal workers. We start by describing the social protection financing gap, moving to look at different approaches to close the gap, including the role of taxation, social security contributions and international aid. The second section highlights a more specific discussion of the challenges that governments face in raising sufficient financing to expand social protection to informal workers in contexts of high informality. We then look at different options to ensure the affordability of social insurance contributions for informal workers and how their integration into social insurance systems can generate additional resources for social protection. Finally, we discuss innovative approaches resulting from the demands of worker movements to gain financial contributions from those who benefit from the labour of workers in informal employment.

Key Points

- The social protection financing gap is the spending that is required to ensure at least a minimum adequate provision of social protection across the life cycle for all. In 2020, the total estimated financing gap for developing countries was about US$ 1.2 trillion.

- Countries have made progress in closing the financing gap by mobilizing more domestic resources. In these efforts, general taxes (including income, consumption, corporate taxes) and social insurance contributions are particularly important. In some cases, countries have increased the social protection budget by drawing from other areas of government spending or taxing natural resources. For low-income countries, international aid can play an important role in augmenting domestic financing and making progress towards universal social protection.

- In countries with a high share of informal employment, mobilizing sufficient domestic resources to finance universal social protection can be challenging. In these contexts, making social insurance systems accessible and affordable for informal workers is an important strategy to expand the financing base for social protection.

- Other alternatives to increase financing for the expansion of social protection to informal workers include innovative approaches that go beyond general taxes and employment-linked financing. By emphasizing the value chains that informal workers operate in, they seek to gain co-financing for social protection from those who benefit from the labour of workers in informal employment.
Strategies to close the social protection “financing gap”

The COVID-19 pandemic has highlighted the urgency of addressing the chronic challenge of the social protection coverage gap. According to the latest ILO estimate (2020), 53.1 per cent of the world population was not covered by a single social protection benefit. In order to expand social protection and effectively reach the population currently excluded, addressing the issue of the financing gap is crucial. The financing gap is the spending required to close the coverage gap and ensure at least a minimum adequate level of social protection for all.

Since the COVID-19 crisis, the financing gap has increased by approximately 30 per cent globally, reaching about US$ 1.2 trillion for developing countries in 2020. Indeed, this gap is reflected in the low levels of public social protection expenditure in low-income regions: in sub-Saharan and Southern Asian countries it is around 4 per cent of GDP, compared to 18.7 per cent globally. According to ILO estimates, the financing gap is largest in Latin America and the Caribbean, Eastern Asia, Eastern Europe and Southern Asia. These four regions account for 66.8 per cent of the global social protection gap, in absolute terms. In relative terms, as a share of the regional Gross Domestic Product (GDP), the financing gap is greatest in Central and Western Asia (9.3 per cent), sub-Saharan Africa (8.3 per cent) and Northern Africa (8.3 per cent). Regarding social protection benefits, older age is the area with the highest spending needs, making up 55 per cent of the total financing gap.

Although countries do face significant challenges in raising revenues, the financing of social protection is as much a political as it is a technical challenge. As a result of different political choices, there are significant differences in social protection spending, even among countries with similar levels of public spending and development. For instance, South Africa, Mauritius and Namibia spend about 3.5 per cent of their GDP on social safety-nets, whereas Nigeria, Kenya and Tanzania spend about 0.5 per cent of their GDP on social safety nets. Furthermore, increased investments in social protection can create a virtuous circle of higher demand, higher productivity, higher growth and a larger fiscal space.

Researchers and practitioners have suggested different policies to bridge the financing gap in low and middle-income countries. The most common strategy generally involves mobilizing more domestic resources, primarily through raising revenue from general taxes and social insurance contributions.

Countries generally use a mix of different taxes to fund their social protection system, such as personal income tax, corporate tax and value-added tax. Low- and middle-income countries collect on average just under 11 per cent of GDP in tax revenue, compared to 16.4 per cent collected on average in high-income countries. These averages, however, hide significant differences. Tax-to-GDP ratios in Organization for Economic Cooperation and Development (OECD) countries range from over 45 per cent in Denmark and France to 17 per cent in Mexico. Furthermore, the tax structure of low- and middle-income countries is often much less progressive (in other words, poor families pay a higher share of their income in taxes than rich families), in comparison to high-income countries. The Overseas Development Institute (ODI) estimates that low- and middle-income countries currently collect on average about

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1 ILO (2021).
2 Durán Valverde, F. et al. (2020).
3 ILO (2021).
4 Transform (2017).
5 Ortiz, I. et al. (2019).
9 OECD (2021).
85 per cent of their revenue potential.\textsuperscript{11} In part due to lower tax revenues, low- and middle-income countries also tend to spend less on redistribution.

According to the ILO, generally there is some room to increase tax revenues even in low-income countries. Good examples of this are Bolivia, Botswana, Mongolia and Zambia, which have introduced taxes on their natural resources to finance their social protection programmes.\textsuperscript{12} Another case was the implementation of financial transaction tax in Brazil,\textsuperscript{13} from 1997 to 2008, that levied 1.4 per cent of the GDP, with very little avoidance and leakage. This tax was framed as a “contribution”, i.e., it was designed to be earmarked to finance social protection and health.

Just like spending levels are to some extent a political choice, so is revenue collection, which becomes clear when looking at tax-to-GDP ratios of low-income countries,\textsuperscript{14} which vary considerably. On the lowest end, Chad raised just above 6 per cent of GDP in total taxes in 2021. Despite also being classified as low-income countries, Rwanda and Uganda raised around 13 to 14 per cent of GDP and Nepal – recently reclassified as a lower-middle income country – managed to generate 23 per cent of GDP in taxes.

Another path to increasing domestic financing for social protection is to step up efforts to collect social security contributions, which globally represent 5.7 per cent of GDP and 18.8 per cent of total tax revenues.\textsuperscript{15} While social security contributions make up a higher proportion of revenues in high-income countries, they are an important income of low- and middle-income countries’ financing strategies as well. As a percentage of GDP, social security contributions generate 1.3 per cent in low-income countries, 2.5 per cent in lower-middle income countries, 3.3 per cent in upper-middle income countries and 8.6 per cent in high-income countries. Measuring contributions as a percentage of total tax revenues highlights their importance in countries’ overall revenue-generation strategies. Globally they represent 18.8 per cent of tax revenues and are relevant for all income levels, making up 9.1 per cent in low-income countries, 10.6 per cent in lower-middle income countries, 15.7 in upper-middle income countries and 24.9 per cent in high-income countries.

A third strategy is to increase the share of the country’s budget dedicated to social protection. In the case of low-income countries, an increase to the same level as mid-low-income countries through the channelling of resources to social protection could support increases in coverage. In response to the Asian financial crisis of 1997, the Thai government funded the expansion of health care mostly by reallocating spending away from the military.\textsuperscript{16} Countries such as Albania, Belize and Cape Verde also have followed similar paths to increase social protection funding.\textsuperscript{17} However, it should be noted increasing social protection expenditure by re-prioritizing budgets can be difficult in resource-constrained, low-income countries where budgets are generally tight and increasing social protection spending should not be to the detriment of other important social sectors, such as education and health.

A fourth route would be to increase Official Development Aid (ODA) to bridge the social protection financing gap. In the near term, most low-income countries will struggle to finance the universalization of social protection on their own, even if they increase revenue collection to the maximum level. Therefore, ODA can play an important role in supporting the poorest countries in implementing at least a basic social protection floor. The argument is that if donors met the aid target of 0.7 per cent of the GDP, all low-income countries would be able

\textsuperscript{11} Evans, M. et al. (2023).
\textsuperscript{12} Bierbaum, M., & Schmitt, V. (2022).
\textsuperscript{13} ILO (2016).
\textsuperscript{14} UN-WIDER (2023).
\textsuperscript{15} Calligaro, F. & Cetrangolo, O. (2023).
\textsuperscript{16} Ortiz, I. et al. (2019).
\textsuperscript{17} Bierbaum, M., & Schmitt, V. (2022).
to afford at least half the social protection costs of poverty alleviation.\textsuperscript{18} A complementary strategy is to push for a relative increase of ODA dedicated to social protection in the overall aid structure. The ODA devoted to social protection (excluding health care) is proportionally much lower than aid for education and health. At home, donor countries spend as much on social protection as they do on education and health combined, whereas in their aid budgets, \textbf{education and health receive seven times more than social protection},\textsuperscript{19} which suggests there might be room to increase ODA for social protection.

A Global Fund for Social Protection could be a game changer for low-income countries’ abilities to establish social protection floors. A coalition of more than 200 civil society organizations argues that such a \textbf{Global Social Protection Fund is needed} to support low-income countries to immediately establish universal social protection floors.\textsuperscript{20} This fund could be used temporarily to top-up the social protection spending of some 12 low-income countries to help them close their financing gap – as the fiscal effort (about 10 per cent of GDP) required for them to establish at least a basic social protection floor would be insurmountable, at least in the short-term. \textbf{This would mean an annual cost of US$ 15 billion, which could be raised} through a combination of additional ODA from high-income countries\textsuperscript{21} and new global taxes, for instance on financial transactions. The civil society authors emphasize the importance of the fund having a \textbf{governance structure} shaped by principles of ownership, inclusiveness, and mutual accountability.\textsuperscript{22}

Finally, \textbf{other options include} eliminating illicit financial flows, using fiscal and foreign exchange reserves, borrowing or restructuring existing debt and adopting a framework more accommodative macroeconomic (i.e., a framework that allows for higher budget deficit paths and higher levels of inflation, as long as it does not jeopardize the macroeconomic stability).\textsuperscript{23} Other studies also suggest that remittances could potentially be channelled to \textbf{finance the extension of social insurance} to the informal economy.\textsuperscript{24}

It is important to consider that some of these alternatives might be more adequate than others for different contexts. Most importantly, these policy choices are not mutually exclusive, and governments are likely to pursue a combination of these strategies to close the financing gap in social protection.

**Challenges and strategies to increase domestic revenues in contexts with high informality**

Countries with the highest financing gap are often economies with high rates of informal employment, which is an important challenge to be considered. In these contexts, it is important to carefully examine the effectiveness and potential consequences of the various strategies to increase revenue that have been discussed earlier.

A \textbf{study by ITUC and Development Pathways}\textsuperscript{25} found that increasing tax revenue to finance social protection through indirect taxation\textsuperscript{26} performs worse in terms of economic growth, employment, and household income across all countries of the study (Bangladesh, Costa Rica,

\textsuperscript{18} Manuel, M., et al. (2020).
\textsuperscript{19} Manuel, M. (2022).
\textsuperscript{20} Global Coalition for Social Protection Floors (2020).
\textsuperscript{21} Cichon, M., & Lanz, H. (2022).
\textsuperscript{22} Kaltenborn, Markus & Kreft, Laura (2022).
\textsuperscript{23} Ortiz, I., Cummins, M., & Karunanethy, K. (2015).
\textsuperscript{24} Kolev, A., & La, J. (2021).
\textsuperscript{25} ITUC/Development Pathways (2021).
\textsuperscript{26} Indirect taxes, in short, are a taxation on goods and services on the supply chain. Direct taxation, on the other hand, is paid directly to the government and is levied on an individual or firm’s income and profits.
Colombia and Georgia). They found indirect taxation causes an additional rise in consumer prices, thereby lowering real income and crowding out consumption and investment, which, in turn, "offset any positive impact from social protection transfers". They argue that direct, progressive taxation would have a better overall performance. This is also one of the policies advocated by the Global Partnership for Social Protection (USP 2030) to improve domestic resource mobilization.

However, increasing tax revenue through direct, progressive taxation in countries with large informal sectors is particularly challenging. Most importantly, high levels of informality make it difficult for governments to tax firms or individual's income, thereby reducing the effective tax base to the oftentimes small formal sector. Since consumption taxes, in such contexts, are more effective sources of revenue for governments of low-income countries, they tend to rely more on this type of taxation, despite being regressive.

Some suggest using universal social security benefits as a strategy to expand the tax base. This would mean, in other words, encouraging informal workers to be incorporated into the tax system by offering to informal workers intermediate social protection benefits, namely, child benefits (such as the Child Support Grant in South Africa), higher than the tax contribution they would pay. In the same line, several studies suggest that informal sector businesses are willing to pay taxes when the benefits outweigh the costs and when there are effective institutional channels for facilitating collective action and bargaining to ensure they receive the benefits. These also would mean reducing barriers for the declaration of income and application of social security benefits, and also a fair and transparent tax system should be put in place.

Sceptics, however, emphasize that in countries with a large informal sector the options to raise revenue are limited. Even if countries increased their domestic revenues to the maximum level, there would be 31 countries in the world that could not afford to finance basic social protection floors on their own.

Some international institutions, in particular the World Bank, argue that countries with a high informal sector generally do not have the ability to raise more revenues through payroll taxes to finance expansion of social protection, a method often used for financing contributory social insurance. The World Bank argues that employment-based social security contributions inherently limit "the potential to cover informal sector workers". The argument is that the traditional social insurance model is increasingly unsuitable for the changing nature of work in which traditional employer-employee relationships are no longer the norm. Furthermore, they claim, the social insurance financing model makes employing formal workers more expensive, relative to informal workers, which risks "creating incentives for workers to remain in the informal sector, particularly when the link between contributions and benefits is not viewed favourably by workers".

However, contrary to the claim that social security contributions are increasingly becoming irrelevant, country data highlights their important role in financing social protection, particularly in middle- and high-income countries, as they have proven to be a stable source

32 World Bank (2022).
34 Underlying this argument is the so-called "perverse incentive thesis", formulated by Santiago Levy. However, a recent WIEGO study reassessed Levy’s claim and puts in question many of his conclusions.
of financing over the past 20 years. They also play a smaller but nonetheless important role in low-income countries. On the one hand, a review of the empirical evidence suggests that efforts to cut social security contributions find no significant formalization or employment gains.\textsuperscript{35} This suggests that social insurance contributions are not the most important barriers to more formal employment. However, reduction in social security contributions create an effective loss in government revenue in the short term, limiting the fiscal space for expanding social protection. Furthermore, there is little rigorous evidence backing up the claim promoted by international financial institutions like the World Bank, International Monetary Fund and Inter-American Development Bank that social insurance contributions incentivize informal employment.\textsuperscript{36}

Instead of relying more on social insurance contributions, the World Bank argues that additional revenue should be raised through a combination of reforms that improve efficiency, harness new technologies to improve compliance, and create new sources of taxation.\textsuperscript{37} In other words, this financing strategy suggests reducing or even abolishing social contributions and replacing them with general taxation, and in particular relying more on consumption taxes.

However, numerous studies highlight the risks of relying heavily on consumption taxes, especially in contexts where poverty and vulnerability are high. Focusing on increasing taxation on the informal economy increases the unfairness in the distribution of the tax burden.\textsuperscript{38} This is in part because informal sector workers already pay more in tax-like payments and fees than is generally assumed,\textsuperscript{39} while tax collectors often overestimate the income potential of small firms. Drawing from the case of Uganda, for instance, evidence shows that informal workers contribute with local fees, and therefore if the push for formalization results in a rise in taxes, it could threaten the viability of the smallest enterprises and drive people into poverty.\textsuperscript{40} In the same line, a WIEGO case study with informal sector operators in Accra, Ghana, finds that they do pay a range of taxes, permits, levies and fees.\textsuperscript{41} Moreover, it finds that informal sector tax burdens are highly regressive, with a disproportionate weight falling on the lowest earning segments of the informal sector.

Despite these diverging views, a consensus appears to be emerging in the social protection sector, which recognizes that while many informal workers cannot afford to pay social security contributions, others can at least partially contribute, but policymakers need to have a more nuanced understanding of their incomes, tax obligations and contributory capacities.\textsuperscript{42} Furthermore, most actors increasingly accept that subsidies may be required to make social security contributions affordable for informal workers.\textsuperscript{43}

\textsuperscript{37} World Bank (2018).
\textsuperscript{38} Gallien, M., Moore, M., & Van den Boogaard, V. (2021).
\textsuperscript{39} Rogan, M. (2019).
\textsuperscript{40} Pimhidzai, O., & Fox, L. (2011). Taking from the poor or local economic development: the dilemma of taxation of small informal enterprises in Uganda. World Bank Africa Regional Project on Improving the Productivity and Reducing Risk of Household Enterprises, Washington, DC.
\textsuperscript{42} Global Partnership for Universal Social Protection to Achieve the Sustainable Development Goals, USP2030 (2023).
\textsuperscript{43} Global Partnership for Universal Social Protection to Achieve the Sustainable Development Goals, USP2030 (2022).
Strategies to ensure the affordability of social insurance contributions for informal workers

Informal workers’ oftentimes low and irregular incomes represent a key challenge to their integration into social insurance systems, as contributions can be unaffordable or not aligned with their livelihoods (i.e. requiring fixed monthly contributions when earnings may be seasonal or irregular).

The World Bank’s response to this challenge is to argue that countries with high levels of informality should move away from the traditional social insurance model based on mandatory contributions and embrace voluntary individual savings accounts, which they argue would help to build resilience to shocks while enabling long-term savings.

Critics of this strategy argue that voluntary schemes tend to feature adverse selection effects, often resulting in a lack of protection for the most vulnerable workers. Another crucial issue with schemes based on voluntary contributions of informal workers is that, in many cases, workers’ income is volatile and considerably low, and, therefore, they may not adequately protect poorer informal workers, unless other measures have provided at least a basic level of protection for all. A WIEGO study on a pension scheme established in 2017 by an informal worker’s union in Ghana provides a strong illustration of how challenging it is, in practice, to build a system based on voluntary contributions. They found that low income, lack of education and awareness about the scheme, and limited trust due to negative experiences with formal social security schemes in the past all operate as barriers towards joining. Indeed, by March 2022, only 1,511 members of the 185,000 total membership (i.e. less than 1 per cent) had joined the scheme.

The ILO also argues that global experiences show the feasibility of increasing financing to social protection by making it easier and more affordable for informal workers to contribute to social insurance. They highlight three key ways to include informal workers in public social insurance systems: adapting the way contributions are determined, facilitating contribution payment mechanisms, and combining non-contributory and contributory financing mechanisms. Examples of adapting contributions include redefining reference incomes for the calculation of contributions (quarterly or annual, instead of monthly, for instance), or considering alternative reference incomes other than earnings, for instance the overall value of a construction project, as the case in India’s construction workers’ welfare boards.

Using simplified contribution and tax payment mechanisms is also one way to facilitate contribution payment and to broaden both coverage and contributions of social protection schemes through benefits linked to employment-based contributions, which would encourage the formalization of the informal economy. Examples of such an approach would be Uruguay’s Monotax, but also similar initiatives in Argentina, Brazil and Tunisia.

Facilitating the payment of contributions could entail, for instance, expanding access points for the payment of contributions through physical access points, online and mobile phone services; or having a more flexible system, allowing for contribution payment to be delayed or interrupted, or for temporary suspension of membership. Other paths include using broad

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45 ILO (2019).
46 ILO (2022).
47 Asafu-Adjaye, Prince (2022).
48 ILO (2019).
50 WIEGO (2019).
51 ILO (2019).
contribution categories according to income or proxy measures to facilitate coverage for workers with volatile incomes, such as in Brazil and South Korea.\textsuperscript{52}

Another important policy choice involves subsidizing the contributions for low-income self-employed workers. In Cape Verde, for social security contributions, micro and small businesses are required to contribute 2.8 per cent of annual sales towards all branches of social security, while workers contribute 8 per cent; in Mongolia and Costa Rica, governments have established matching subsidies for informal workers (ILO-WIEGO report, forthcoming).

There are also alternative financing models to expand social protection coverage to informal workers, using co-financing social protection through value chains, inspired by extended producers’ responsibility (EPR) frameworks. In Argentina, a new Packaging Bill stemming from the pressure of workers’ organizations (UTEP) and inspired by the EPR framework provides that packaging-producing companies should contribute directly to the financing of inclusive recycling systems.\textsuperscript{53} As a result, this can potentially improve work conditions and increase access to social protection for informal waste pickers, in particular occupational health and safety and access to health care. This revenue also increases waste pickers’ ability to access and contribute towards the national Social Monotributo tax and, thus, to be covered by other social protection services. In India, in the state of Pune, a trade union of waste pickers (KKPKP) has leveraged its contributions to the waste management system of the Pune Municipal Corporation (PMC) to provide social protection benefits, as well as better work conditions, from a variety of entities beyond the standard employment relationship.\textsuperscript{54} Both cases show that it is possible to tap into other financing sources to finance social protection extension to informal workers, even in cases where the figure of the employer is absent.

Another example of models to bridge the financing gap for extending social protection to informal workers also comes from India. These models follow a principle similar to the EPR cases, in the sense that those who benefit from the labour of informal workers have to contribute to financing their social protection, even if they are not their employees. The so-called Welfare Boards are entities comprised of representatives of workers, employers and government. Several such boards exist, in different states and catering for specific sectors of workers. The Welfare Boards raise funds by levying a tax on the production of specified goods, or through contributions from various sources including employers, employees, and the government.\textsuperscript{55} The central innovation of the Indian welfare boards lies in this legislated ability to gain financing from those who benefit from informal workers’ labour, even if they are not in a direct employment relationship. The funds are used for expenditures related to the welfare of workers, such as health care and child care, as prescribed in the laws or schemes under the Board.

\textsuperscript{52} ILO (2020).
\textsuperscript{53} Cappa, A. et al. (2023).
\textsuperscript{54} Chikarmane, Poornima and Lakshmi Narayanan (2023).
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About WIEGO

Women in Informal Employment: Globalizing and Organizing (WIEGO) is a global network focused on empowering the working poor, especially women, in the informal economy to secure their livelihoods. We believe all workers should have equal economic opportunities, rights, protection and voice. WIEGO promotes change by improving statistics and expanding knowledge on the informal economy, building networks and capacity among informal worker organizations and, jointly with the networks and organizations, influencing local, national and international policies. Visit www.wiego.org.