Research Paper

Barriers to Pension Scheme Participation by Workers in the Informal Economy

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June, 2006

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PART ONE

Introduction

One of the fundamental global problems facing social security protection today is the fact that more than half the world's population which includes workers and their dependants are excluded from any type of social security protection. Non-coverage is greatest in Sub-Sahara Africa and South Asia, where more than 90 per cent of the population are not covered at all. A major contributing factor towards decreasing and low levels of social security coverage in these regions is the trend towards greater informalization or flexibility in labour market conditions, which in essence leave majority of workers outside the realm of social protection systems.

The situation is more complicated in developing countries where a large majority of non-covered and poor workers are employed in the informal economy. The informal sector in Kenya employs over 75 per cent of the work force today. The output of this sector contributes considerably to the economic outpu of the country. The sector however, remains on the whole, unaccounted or underestimated. The income and continued employment of the informal sector worker is usually varying and uncertain. The uncertainty in their work reflects the uncertainty of markets, the recession or boom, the needs and whim of an employer, the political situation, changing policies and other factors. In summary, the economic security of workers in the informal sector is dependent on a variety of factors over which they have no control. Unlike the formal sector employees who are shielded from economic insecurity by an employer or an institution, the informal sector workers have to face the risk on their own.

Continuity of work and a reasonable income is the top priority in their lives.

Employment, however, is not just about work and income. During the working life, a worker has to meet many personal, social and family needs – and with growing commercialization, these needs are met mainly from their income, which in itself is uncertain. There are also times of personal crisis such in retirement and droughts, where the worker has to spend but at the same time is not able to earn an income. These are challenging times when social security assistance will be very necessary. The informal sector worker thus needs adequate savings or social security initiatives to act as a cushion against economic uncertainties.

This paper attempts to shed some light on the problem of poor coverage of social security (retirement benefits) using secondary information gathered from different works by scholars and professionals. The findings of this research may be controversial but it is hoped that they will help explain the existing gaps in social security coverage.

The Informal Sector

For the purpose of this paper, informal sector will mean small scale enterprises both in production and services industries. Their goods and services are not accurately recorded in the government figures and accounting mainly because of poor record keeping and failure to declare for fear of paying taxes. The informal economy which is not generally taxed commonly includes trading in goods and services such as day care, tutoring, blacksmith, Jua Kali Artisans, Mama mboga, small shops and kiosks.

The term ‘informal economy’ has come to be widely used to encompass the expanding and increasingly diverse groups of workers and enterprises in both rural and urban areas operating informally.

PART TWO: BACKGROUND INFORMATION

Evolution of Social Security

The oldest institution of social security in the history of mankind is the family. Closely connected by flesh and blood, inspired by tales of filial devotion, fraternal affection and parental sacrifice and encountered by various religions, every member of the family considered it as a part of his duty to share all they have with other members. Income from family property and family labor was pooled together and used for the maintenance of all members, whether productive or non-productive. Thus the family was in the past the bulwark of society and still is to some extend the epitome of what the word security connotes to most people. The family assumes the task of specializing individuals from early days, providing the necessary training to condition members to the socio-cultural framework of the society and to equip members to face life as an adult. It also constitutes a protective haven sheltering its members from the harmful forces of outside world. A family mainly consisting of adult parents and dependents children may even include two or more generations related by birth, sharing a common household with a commonly accepted division of labor, constituting an extended or joint family.

Another aspect binding people to each other was the love of their community and the fairly close-knit community set up. It was a matter of pride to every member of community that those who were old, ailing, infirm, physically or mentally handicapped, or single mothers were looked after by the community as a whole. Thus the word 'security' was almost synonymous with the family so that with the protection of one's family, one was rarely exposed to the vagaries of changing circumstances and individuals often progressed through a lifetime from the 'cradle to the grave' within the protective shell of family.

Most of the advanced nations had developed comprehensive social security systems in their countries by the beginning of the 20th century. However, the colonies under their long rule continued without any meaningful social security arrangements. No worthwhile social security schemes were introduced in these countries, except for some arbitrary schemes for compensation in case of employment injury and maternity benefits in large manufacturing establishments that formed the tiny formal sector. It was after the First World War in the case of South American countries and after the Second World War in the case of most African and Asian countries (after their independence) that some steps were taken towards social security. However, there remains much to be desired in terms of benefits level and coverage of social security in these countries. The expectations of people in the developing countries are much higher compared to situation in developed countries in the early period of the evolution to social security. Moreover, the historical time available to these poor countries is short and they are in away pressurized, due to both internal and external factors, to telescope the time available to them meeting developmental goals in general and social security in particular. A greater sense of urgency has now been imparted as a result of the unfolding of a process of globalization driven by the neo-liberal ideology that has given rise to a heightened sense of social insecurity among the developing nations and vulnerable sections (including informal sector workers) of people within these countries.

The new needs for income protection were not at first recognized as a concern of the state. The individual was thought to be responsible for his own welfare and capable through work and thrift and care for himself and family. The breakup of joint family system following the emergence of the urbanization and industrialization and in the process, withering away of the institutional base for security and support made it clear that security in old age in case of need had to be increasingly provided by society through its own solidarity. It is on this background that people in the informal sector should think of means and ways to come up with some kind of security in old age. These can be in terms of joining existing individual pension plans or coming up with other means of social security for old age.

Current State of Coverage

Social Security Coverage to the informal sector workers is still very low and a lot of efforts need to be made to educate the informal sector worker on the importance and means of saving for retirement. The informal sectors' workers need to be encouraged through the incentives and education to become members of a scheme relevant to informal sector. This will enable them to accumulate savings for retirement, hence be able to maintain their standards of living when they retire from active pursuit of daily bread. Retirement Benefits Schemes are institutionalized tax incentive based vehicles through which workers in both formal and informal sector can save part of their income to ensure that they have adequate income after their active working period. There is however no clear policy on retirement benefits mechanism for the informal sector employees; since more emphasis has been given to occupational schemes whose coverage is still low.

Pension reforms in Kenya should generally be a top government agenda to be able to create an enabling environment so as members from the informal sector. Generally, over 85 per cent of the Kenyan workforce is currently not covered by any form of retirement benefits saving vehicle.

One area where provision of retirement benefits scheme is notably poor is amongst people working for small and medium size enterprises. These businesses, as per recent statistics, employ more than 60 per cent of the working population in the country (Economic Survey 2005). The high proportion of workers in the informal sector and the low coverage of retirement benefits scheme for workers in the informal sector raises the question on whether there are particular barriers to pension schemes participation in this segment of the economy, and if so, what can be done to improve the situation.

Making the appropriate choices is widely considered to present substantial demands upon individuals in this sector. Individual schemes are said to be too complex, whilst the information supplied about them is usually opaque and can not be easily be understood by workers in the sector. Over and above this, the level of financial literacy is widely accepted to be too low to enable the informal sector employees to analyze the requisite data, even if these data were presented more transparently. There is plenty of evidence from literature that the informal sector workers are myopic, and have very high discount rates, so that pension saving is given low priority. For all these reasons, individuals in the informal sector, left to choose on their own, are likely to save inadequately or inappropriately, through risky investment products. This has led to proposals for choice to be curtailed, and even for the advocates of limiting choice to suggest that 'libertarian paternalism is not an oxymoron' (Sunstein and Thaler, 2003).

The environmental changes can make people less willing either to participate in saving for retirement because of the resultant uncertainties, and more importantly, adverse changes in that environment can have a greater negative impact than, *prima facie*, appears justified. A particular event in the environment can undermine the confidence of a particular group of people, and can have far wider consequences in that it generates a wider lack of confidence. In this respect, its impact is 'contagious'.

The term 'contagion' has been used by international financial economists to describe the domino effects resulting from failures in individual economies or sub-systems of these economies. Other economies, or sub-systems of an economy, contiguous with, or perceived as sharing some of the characteristics of the initial economy or sub-system, are treated in the same way as that initial economy or sub-system. Confidence in them falls; investors desert them. This happens whether or not the lack of confidence is deserved, or is deserved in full. The concept of 'contagion' provided the basis for analyzing the South-Asia financial crisis of 1997. Analysis of this and succeeding ‘crises’ was couched in terms of ‘spillover’ and ‘flight to quality’ (IMF, 1999). It was also much used in the period following the collapse of the energy trader Enron, where commentators were concerned with ‘fallout’ and ‘guilt by association’ (Gleckman, 2001). Insofar as stock market falls, accounting scandals, provider failures, or perceived shortcomings of regulators or government policy can provoke a loss of confidence in private pension provision, they, too, can have ‘contagion effect’.

They can engender skepticism and taint the credibility of such an approach to the financing of old age, either because they call into question some of the precepts upon which it is based, or because they reveal weaknesses of key actors or institutions. Linkages are made, whether or not they are entirely applicable, and conclusions are drawn, whether or not they are entirely valid.

Examples of ‘contagion’ in Europe

Within those European countries where private pension systems have been introduced on a voluntary basis, there has been concern about low levels of take-up. In the case of Germany, take-up of the ‘Riester pension’ fell well below aspirations. This pension, which became available at the start of 2002, offered workers the opportunity to compensate for the step-by-step cuts in the public pension that had also been legislated. Subsidies were offered to those who chose to participate in the scheme. Initially, the government had expected that between two thirds and three quarters of those eligible would open a private pension account within the first year (Mesa-Lago and Hohnerlein, 2003). In fact, it appears as if no more than one in ten have done so – sufficient to prompt not only the government, but also representatives of the insurance industry, to suggest that compulsion might be necessary.

Equally disappointing has been the take-up of ‘stakeholder pensions’ in the UK. These became available in spring 2001 and were a component of the government’s efforts to encourage lower paid people to make some supplementary provision for their old age. However, not only has the target group been missed, in that only some 40 per cent of the stakeholder plans opened were opened by such people, the absolute number of plans started has been much smaller than hoped. The number of individual plans opened fell off almost continually after the first few months, and a substantial share of these were not plans opened by new savers but plans opened by people seeking to transfer their pension savings from a ‘personal pension’ scheme they had opened earlier. Moreover, at least 80 per cent of the collective stakeholder plans – those ‘designated’ by employers – have yet to receive any members (Association of British Insurers, 2003).

The problem of non-coverage

A very large proportion of the population in most regions of the world still does not enjoy any social protection or are covered only partially. This is the case for vast majority of people in developing countries Kenya included, and even in some developed countries there are large and growing gaps in social protection coverage.

Informal economy workers are not covered by social security for a variety of reasons. One is the extreme difficulty of collecting contributions from them and, as the case may be, from their employers. Another major problem is that many of these workers are unable to contribute a percentage of their incomes to financing social security benefits and unwilling to do so when these benefits do not meet their immediate or priority needs. Their most immediate priorities tend to include health care, in particular where structural adjustments measures have reduced access to free Medicare services like here in Kenya. They feel less need for pensions, for example, as for many of them old age appears very remote and the idea of retirement unreal. Unfamiliarity with social security schemes and distrust of the way the schemes have been managed in the past (example is the NSSF) compound to their reluctance to contribute to a retirement benefits scheme.

The problem of low coverage is not new, especially in countries where large numbers of people work in subsistence agriculture. However, in the recent years, prospects of resolving or at least mitigating it has taken a drastic turn for the worse, as an increasing proportion of the urban workforce is working in the informal sector, as a result of structural adjustment programs which resulted in mass retrenchment and redundancies.

It should be noted that the informal sector is not really a sector on its own but it is a phenomenon to be found in almost all sectors. Informal sector employment in Kenya accounted for almost three-quarters (75 per cent) of total urban employment in 1996, compared with just 10 per cent in 1972 (ILO). Several developing countries have expanded wage employment substantially but the informal economy remains very important almost everywhere. In India, for example, if agriculture is included, more than 90 per cent of workers are to be found in the informal sector.

In many countries, a higher proportion of women work in the informal economy, to some extent because they can more easily combine work with their other burden of family responsibility, and partly for other related reasons, such as gender discrimination encountered in the formal sector. ILO statistics show that in two thirds of countries for which separate figure were available, informal economy accounts for a higher share of total urban employment for women than the case for men. There is a wide spread tendency for women to be trapped in the informal economy for much of their working lives, whereas for men – in the industrialized countries at any rate – it is less likely to be permanent. For long term security such as old age, this difference has important implications, as women tend to live longer than men.

Informal sector workers have little or no security of employment or income. Their earnings tend to be very low and fluctuate more than that of other workers. A brief period of incapacity can leave the workers without enough income to live on. The sickness of a family member can also result in additional costs that can easily destroy the delicate balance of the household budget. The working conditions are often intrinsically hazardous and more so, the fact that it takes place in unregulated environment.

Table 1

Total Recorded Employment: June, 2000 - 2004 **000's**

	2000	2001	2002	2003	2004
Modern Establishment - Urban and Rural Areas:					
Wage Employees	1,695.4	1,677.1	1,699.7	1,727.3	1,763.7
Self - employed and unpaid family workers	65.3	65.4	65.5	65.7	65.8
Estimated Informal Sector	4,191.1	4,667.3	5,101.6	5,532.7	5,970.6
TOTAL	**5,951.8**	**6,409.8**	**6,866.8**	**7,325.7**	**7,800.1**

* Source: Economic Survey 2005

Women face traditional disadvantage due to discrimination related to their reproductive role, such as dismissal when they are pregnant, or upon marriage. Women in the informal economy do not benefit from safeguards and benefits related to child rearing that in principle apply to women in the formal wage employment such as paid maternity leave and assistance towards child care.

It is now widely recognized that there is need to find effective ways to greatly extend social security coverage. The recent past has witnessed stagnation in the proportion of total labour force covered by social security programmes. Given the current economic trends, failure to take early action is very likely to lead to a reduction in coverage.

PART THREE: ATTEMPTS TO INCREASE COVERAGE

Policies to achieve the extension of coverage

Outside the industrialized world, policy-makers have found few remedies for the lack of social protection. This may be mainly because of the fact that the existing social protection policies are inappropriate for the local conditions. It may also be because insufficient efforts have been put to implement the existing policies. In addition, it may be because the lack of social protection is related to economic, social and political problems. It should also be noted that policy makers define the problem of poor social security coverage too narrowly; their chances of finding feasible solutions may be greatly reduced. It is necessary therefore, to give full consideration to the wider context in which social security systems to operate. It is also worthy considering some new policies aimed at increasing coverage.

Use of inducement or compulsion

The question that arises in very many peoples' mind about this is that "Why the governments should be concerned whether people save enough for their retirement?" In a society that emphasizes personal responsibility, the decision on how to allocate one's income over time should be personal and not subject to compulsion or influence by a third party. Out of compassion, a society could provide social assistance to those who reach old age with inadequate financial means for subsistence and survival. But why should governments wish to encourage saving for retirement: that could provide higher levels of income in old age than those obtainable from social assistance?

The answer is that such policies have been popular with the public mainly because of three reasons. **First**, they protect society from those who fail to save in the expectation that they will be catered for by the society when they reach old age. This might be called a "weak moral hazard" since society's willingness to take care of the old homeless and destitute cannot be taken for granted. In fact, the growing number of poorly catered homeless people in most high income countries, not to mention the large numbers of beggars in poor countries like Kenya, should cast considerable doubt on the relevance of this argument. **Secondly**, they protect a substantial minority of workers, perhaps even a majority, from their own shortsightedness. And, **thirdly**, they protect the non-myopic workers from footing the bill for the myopic ones (James 1998). Whether people (or at least a substantial proportion) are "myopic" in their saving behavior should be empirically verifiable, but in fact there are no hard data to support or reject such assertions. In the absence of hard facts, one falls back on intuition and inference from observed behavior. Young people are more "myopic" than the old. Biologically, infants clamor for instant gratification and the young are impulsive, while the very old contemplate death and the afterlife. Thus, intuition suggests that the young have a higher discount rate than the old.

Poor people in the informal sector also tend to have a high discount rate. Forcing these people to save raises some important policy, even ethical, issues. How fair is it to compel poor people to defer their already low level of consumption for their future retirement needs? At an extreme level of abstraction, depriving poor people of the ability to meet their basic needs may cause more problems, thus negating any concern about their possible future destitution. But even at a less extreme level of abstraction, poor people and even middle income people in both formal and informal employment have other more pressing needs for housing, education and healthcare than their future retirement needs. Thus, compulsory participation in saving for retirement needs to be properly calibrated.

Libertarian economists who favor freedom of choice argue that high discounters should be allowed to save less and suffer the consequences of their choices when they reach old age. The problem with this point of view is that the discount rate changes with age. Many people regret later in life their failure to save more when they were younger. Many people also like the discipline that is entailed in non-discretionary long-term contractual savings plans. This is perhaps why both social security and occupational pensions have enjoyed a high degree of popularity as long as their promises have been credible and generous. The growing dissatisfaction with social security around the world stems from the fear that the value of benefits will not be sustained. In many developing countries, the existence of widespread evasion undermines the argument that social security is popular. However, widespread evasion may not be the result of unpopularity but rather of faulty design and poor administration in Kenya we have an example of NSSF. Experience from other countries like the USA, UK and the Netherlands suggests that a well-designed, efficiently administered and credible social security system continues to be popular.

Similarly, growing concern about occupational pensions derives from the realization that they depend on the integrity and solvency of large employers. These can no longer be taken for granted as employers change pension plans in response to their particular circumstances. These problems suggest the need to change the form and modalities of retirement saving, not to do away with compulsion. Compulsory provision for retirement can be justified by reference to the myopic behavior of a substantial minority of people and the need to protect both these people and the public at large from their shortsightedness. To what extend can the compulsion be? In most countries, participation in a social pension system involving some redistribution is compulsory but participation in private pension plans is voluntary (or quasi-voluntary).

Clearly, ensuring a minimum pension level offers greater justification for compulsory provision than ensuring a pension level that implies maintenance of a pre-retirement standard of living and a high replacement rate of pre-retirement earnings. But as the real value of social security pensions declines, the case for compulsory participation in private pension plans that promise a modest but satisfactory overall replacement rate becomes stronger. If the principle of compulsory provision is accepted then tax incentives also are desirable. Tax incentives may provide a powerful inducement to promote compliance and thus encourage long-term saving for retirement purposes. Whatever the objectives and modalities of saving, a combination of compulsion and inducement is likely to be powerful than either one in isolation.

Rate of contribution

The question that arises in this context is “which is the right/better contribution rate?” The answer to this question depends on what is considered as an appropriate targeted pension level and on whether there exists a separate redistributive public pillar. Experience from Latin America suggests that a contribution rate for long-term capital accumulation of less than 5 percent would not be adequate.

In Chile the total contribution rate used to be around 13 percent --10 percent for long-term capital accumulation plus around 3 percent for operating fees and insurance premiums. In recent years, the latter started to fall, reaching 2.1 percent in 2000.
In Argentina, the contribution rate for the second pillar amounts to 11 percent (7.5 percent for long-term capital accumulation plus 3.5 percent for operating fees and insurance premiums). In Mexico, the minimum contribution rate is 6.5 percent to the individual retirement account plus another 5 percent that is credited to an account operated by a housing finance institution. The government adds a flat contribution that corresponds to around 2.5 percent of the average wage. Operating fees are deducted from these contributions, but disability and term life insurance (which covers survivor benefits) is operated by the traditional social security institution, and involves a premium of 2.5 percent.

In Hungary, the contribution rate to the compulsory funded pillar was initially set at 6 percent, with provision for its increase in two annual steps to 8 percent. However, the government that took office in 1999 has indefinitely postponed implementation of this provision and has frozen the contribution rate to 6 percent. In Switzerland there is no minimum required contribution rate. Swiss law only requires that employer contributions are at least equal to those of employees. In practice, employers cover two-thirds of annual contributions. The minimum legal requirement is for credits to be made to notional individual accounts based on a worker's age combined with a minimum notional return of 4 per cent per year. Plans that achieve high investment returns may operate with zero contribution rates.

In general, a rate of 10 percent for long-term capital accumulation would be adequate for a reasonable replacement rate of between 40 and 50 percent if investment returns exceed wage growth rates by 2 to 3 percentage points and if active working life is at least twice as long as passive retirement life (the latter calculated to include the life expectancy and benefits of dependent survivors - Vittas 1993). A lower replacement rate would be achieved if the gap between investment returns and wage growth is smaller or if careers are interrupted. Under these conditions, a 10 percent contribution rate would still be adequate if the targeted replacement rate from the funded pillar amounts to 35 percent and this is supplemented by a pension of similar magnitude from the unfunded public pillar.

Benefits on retirement

Benefits can take several different forms: lump sums on retirement, lifetime pensions, pensions for surviving dependents, and pensions for disability. Historically, there was a clear distinction between provident funds that paid benefits in lump-sum form and pension funds that offered life annuities. Over time, however, the distinction became blurred. Most pension funds now allow commutation into a lump-sum payment of up to one-third of the present value of accumulated balances, while provident funds require the purchase of an annuity or the lump sum. Singapore introduced a minimum-sum annuity requirement in 1988. Pension systems that are based on personal pension plans require either the purchase of life annuities or the use of scheduled withdrawals (also known as income drawdowns in the United Kingdom or allocated annuities in Australia). Scheduled withdrawals, which were an innovation of the Chilean pension reform of 1981, are recalculated annually, taking account of investment returns and the remaining life expectancy of pensioners (and their dependents), but they do not provide longevity insurance. In Chile, and other countries following its lead, lump-sum withdrawals are allowed if the annuity payment exceeds a certain replacement rate (usually 70 percent of reference salary).

In designing pension systems a differentiation of compulsory accumulation from compulsory annuitization is advisable. This is because private annuity markets suffer from structural problems and are not well developed even in the most advanced countries. To a large extent, the underdevelopment of annuity markets is due to the crowding out effect of social security and occupational pensions that predominate in advanced countries. Pending the development of more efficient annuity markets, it would be preferable to limit compulsory annuitization to a level of around 35 percent of average earnings and subject any excess balances to scheduled withdrawals, but with flexible arrangements for major health and other emergencies (Blake et al 2000, James and Vittas 2000). The development of variable annuities with floors and caps as well as the use of more transparent participating annuities could address some of the problems facing annuity markets. The 35 percent target should apply to the combined pension from the unfunded public pillar and the private funded one. Thus, workers should be encouraged to accumulate enough retirement savings to support a replacement rate of around 70 percent of pre-retirement income, but only half of that should be required to be annuitized.

In addition to benefits for retired workers, pension systems need also to provide disability insurance to cover active workers and their dependents from the effects of serious accident and term life insurance to protect the dependents of active workers in case of death.

In Latin American countries, these insurance policies are organized on a group basis, a feature that lowers costs and could also be used in annuity business. Other benefits for active workers could include provisions allowing pre-retirement withdrawals for housing, education, health care and various emergencies like funerals and sickness.

Many countries allow use of pension or provident fund balances for such purposes. Too liberal use for non-retirement purposes runs the risk of depleting accumulated balances and leaving too little capital for retirement. Alternatively, it may cause the mandated contribution rate to be too high as is notably the case in Singapore. On the other hand, a blanket prohibition of early withdrawals for housing, education and healthcare would unfairly penalize low and middle-income workers and would weaken support for participation in retirement saving plans.

A compromise solution would be to permit a certain amount of withdrawals but subject to some sensible aggregate limit. In addition, repayment of early withdrawals or replenishment of account balances could also be required. A sensible aggregate limit could allow withdrawals equal to 100 percent of accumulated balances or 30 percent of projected balances at normal retirement age, whichever is lower". In this way, young workers would be bound by the first limit, while older workers would be bound by the second limit.

Regulation and supervision

A government that imposes a mandatory retirement saving system has an obligation to ensure that it is safe, works well, is simple and easy to understand, and will deliver the promised benefits. This obligation is clearly stronger in developing countries where millions of affected workers may lack familiarity with the workings of modern financial markets.

The main focus of regulation should be on prudential and protective norms and fiduciary standards. First and foremost are licensing rules that should ensure that only persons satisfying a stringent "fit and proper" test are allowed to act as sponsors, founders, directors, trustees or senior executives of pension funds. Other rules should require a specified minimum capital, asset diversification and market valuation, external financial audits and actuarial reviews, and extensive information disclosure and transparency.

Of particular importance are rules on adequate fund governance, well-developed internal control systems, legal separation of the assets of the pension fund from those of the Management Company, and proper custodial arrangements. All these prudential and protective rules are necessary to ensure the financial soundness of pension funds, prevent fraud, self-dealing and other potential conflict-of-interest situations, and safeguard the interests of workers.

The above regulations are non-controversial, but are difficult to achieve. Ensuring an efficient and adequate supply of auditors, actuaries and custodians, not to mention experienced examiners and supervisors, is a tall order for most developing countries. In Chile, effective external custody of pension fund assets was secured by requiring all assets to be held with the central bank for safe keeping during the first ten years of the new system. Private custodians were allowed in the 1990s. The development of automated central securities depositories in many countries around the world has simplified the requirement for safe external custody.

Other rules that have been practiced in Latin American countries are more controversial. The "one account per worker", "one fund per company", and "uniform pricing" rules have aimed at ensuring simplicity and transparency and thus providing protection to workers, but their usefulness is open to question. They could be justified in systems that offer constrained choice, although they should probably need to be supplemented with regulations and limits on operating fees, agent commissions, and account switching. They would be out of place in systems that emphasize personal choice. In such systems, they would need to be relaxed in the longer run in order to offer more effective choice to workers.

To enforce compliance with the whole panoply of prudential and protective regulations requires the creation of an effective, well-funded, properly staffed and proactive supervision agency. Latin American countries, and to a lesser extent the reforming countries of Eastern Europe, have been more successful than most OECD countries in developing effective supervision of private pension funds. Following modern practice, supervisors should enlist the support and cooperation of auditors, actuaries and custodians.

In several high-income countries, pension fund supervision lacks adequate and reasonably up-to-date information and is slow to take corrective action. Given the very long-term nature of pension contracts, it is imperative to develop a system of supervision that is proactive and effective, stimulates transparency, and ensures compliance with basic prudential and protective rules.

PART FOUR: CONCLUSIONS

Those lacking social protection tend to belong to economically weaker section of the society. The aim should be in the long run to extend the coverage to over 60 per cent of the labour force in Kenya.

Policies to promote saving for retirement and old age should ideally use both tax incentives and compulsion. The case for compulsory provision is based on the need to overcome the myopic behavior of a large minority of workers and to protect society from those who make inadequate provision for their old age.

Compulsory provision imposes an obligation on the state to ensure that the system is safe, works well, is simple and easy to understand, and will deliver the targeted benefits. Important policy issues include the extent of compulsory coverage, the form and size of compulsory saving, the management, regulation and guarantees of the compulsory system, and finally the extent of individual choice.

Tax inducements may facilitate compliance. The socially superior way of providing tax inducements would be through a credit transfer that is added to individual capitalization accounts provided a minimum rate of saving is observed. This would encourage participation by low income groups in the informal sector.

The goal of social protection is not mere survival, but social inclusion and preservation of human dignity. The government should seek to extend coverage, seeking some information and experiences from countries where social security is popular and enjoys a high degree of public support. There are no simple solutions, and the prospects of success of various strategies will vary according to the support the government gives.

A minimum level of compulsory annuitization should be required and this should be less than the targeted level of compulsory accumulation. Balances in excess of the minimum level of annuitization could be used in a more flexible way both before and after retirement. Withdrawals for housing, education and healthcare could be allowed but should not exceed the lower of 100 percent of accumulated balances or 30 percent of projected balances at retirement.

The regulatory framework needs to be robust and effective. The whole panoply of prudential and protective rules would be essential. This should cover "fit and proper" tests for the founders, sponsors, directors, trustees, and senior executives of pension funds, asset diversification and market valuation rules, legal segregation of assets and safe external custody, independent financial audits and actuarial reviews, and adequate disclosure and transparency. An effective, proactive, well-funded and properly staffed supervision agency is necessary.

Tight investment guidelines could initially be justified for countries with weak capital markets and limited tradition of private pension provision. However, in the long run, adoption of the "prudent expert" approach with publication of "statements of investment policy objectives (SIPOs)" would be preferable and more efficient. Various guarantees covering aspects such as minimum pension levels and relative investment returns need to be provided to protect workers from aberrant asset managers but care must be taken to address effectively the risk of moral hazard.

The informal sector has to have a strategy, which is sector specific, activity specific, location specific and organized at the national level. A viable body has to be built and utilized for the welfare of workers employed in the informal sector. Larger the body, the greater would be its viability and sustainability. There are several instances in the informal sector where there is no visible relationship between the employer and the employees such as in case of home workers, shoe shiners, etc. In such instances, the boards constituted for the management and the administration of the body, should in addition to the three principle players viz. the government, employers and workers, include NGOs in order to ensure that the voice and interests of those whose employment relationships lacks clarity is taken care of. The private sector with its expertise in judicious investment of funds can also be involved alongside the NGO's.

Recommendations

1. The government should review the structure and financing of social security schemes to ensure that they correspond more closely to the needs and circumstances of excluded persons and in particular those who work in the informal sector and agricultural plantations.

2. The Retirement Benefits Authority should raise awareness and mobilize key actors and partnerships, in particular with possible donor countries and agencies, to ensure a broad basis of support for the implementation of the campaign.

3. The Retirement Benefits Authority should improve the overall understanding of social security through conducting research on extension efforts, documenting best practices worldwide, developing new mechanism to reach out to workers in the informal sector and creating guidelines for extending basic benefit entitlement.

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