

The background of the cover is a photograph of an elderly woman from behind, wearing a bright green patterned sari and a matching headscarf. She is standing on a concrete step in front of a blue-painted wall and a wooden door. The wall has a textured, peeling paint effect. The woman is looking down, and her right foot is visible, wearing a simple silver anklet.

SAVING THE NEXT BILLION FROM OLD AGE POVERTY

global lessons for local action

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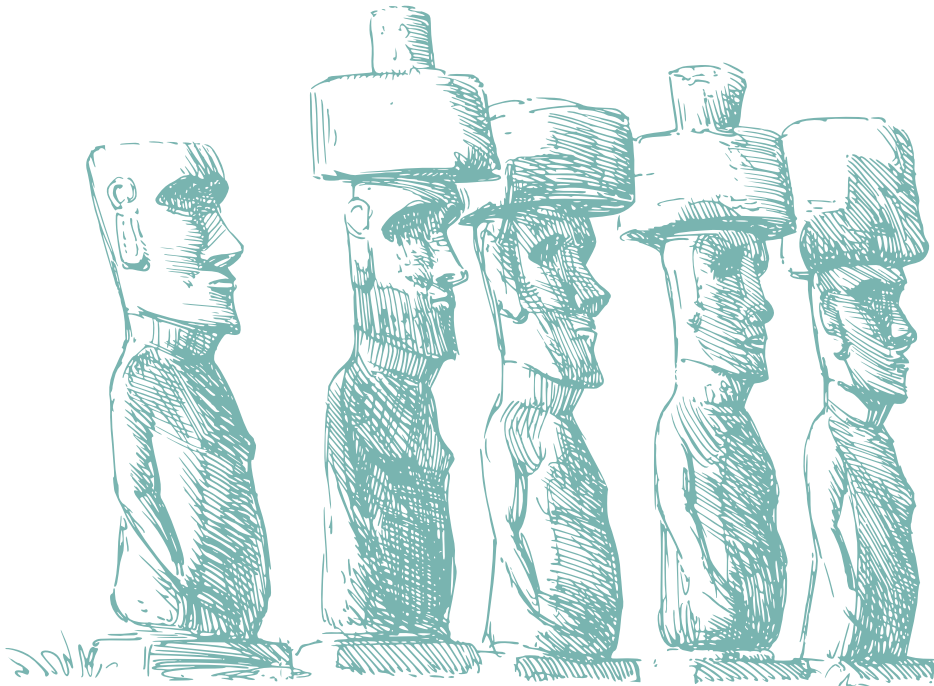
INCLUSION OF THE SELF-EMPLOYED IN THE PENSION SYSTEM **IN CHILE**

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INTRODUCTION

In 1981, Chile replaced its traditional pay-as-you-go (PAYGO), unfunded, public sector managed pension system, for a new and innovative national pension system based on individual accounts managed by private pension fund managers.¹ When first introduced, it was assumed that if people spent enough time in covered employment (up to 95% of their working life) and pension funds obtained adequate returns (5% to 6% real annual return), a 10% contribution rate would be enough to achieve a replacement rate of 70% for participants in the new system. However, in reality observed replacement rates have been much lower, at around 50% for men and 35% for women on average.

Many factors contributed to the low replacement rates observed in the system, but one of the most important was the high mobility of workers in and out of the formal sector, which translated into a small percentage of working lives spent contributing to the pension system (defined as low ‘contribution densities’ in the literature).

Chile is characterized by a lower level of informal labour market compared to most other countries in Latin America. However, evidence has shown high mobility between the informal and formal sectors in Chile, coupled with short term contracts in formal jobs. Since pension contribution is mandated only for salaried workers, participation in the formal sector is key for pension coverage and for achieving high densities of contributions. On the other hand, although participation is open for the self-employed on a voluntary basis, in reality, only a minimal proportion of the self-employed contribute to the pension system in Chile (5% on average up to 2012).

To reduce disparities, in 2008, Chile introduced comprehensive reforms aimed at increasing coverage, improving adequacy, reducing costs, and strengthening the institutional framework of the pension system. While the privately managed individual savings structure of the system was retained, a new non-contributory pillar was introduced. Additionally, measures were taken to increase coverage, reduce fees, improve gender equity, reorganize the market and more effectively supervise pensions.

A key finding in the technical analysis that sustained the reform was that lifelong careers as salaried workers were increasingly rare and there was a lot of movement between formal and informal jobs as well as in and out of the labour force. Though many self-employed workers could save as much as salaried workers, they were not contributing or saving for retirement in any other way. Furthermore, making the transition into formal jobs was quite difficult for first time job seekers, which reduced their ability to start accumulating early retirement savings thus failing to gain the benefits of compound interest. This problem is seen in many countries. The U.K.’s review of auto-enrolment in 2017 will also aim to focus on ways to improve coverage and contributions from the self-employed.

¹ The 1981 reform was quite unusual in moving from a solely public to a predominantly private pension system, followed by other countries in the region such as Mexico in 1997.

While taking measures to increase the adequacy of pension benefits, it was important that the coverage of the contributory system should expand to the self-employed and young workers. As described later in this chapter, a relevant part of the periods that saw no contributions to the pension system can be attributed to self-employed workers, especially men.

An important challenge, when imposing mandatory contributions on the self-employed, is the enforcement of such a measure. In the case of formal salaried workers, payment of contributions and their enforcement is facilitated by payroll deductions and a collection mechanism that facilitates payment of contributions by employers in bulk for all their employees. In the case of many self-employed individuals, earnings are not easily observable and no such routine collection mechanism exists. In the case of the Chilean reform, it was decided that the target population would consist of some “formal” self-employed workers who are paid for services delivered to a third party and who issue an invoice or receipt called *“boleta de honorarios”*, against which a tax retention is collected. This portion of self-employed workers typically prepare an annual income tax declaration and receive a tax refund or pay additional taxes depending on their total annual income.

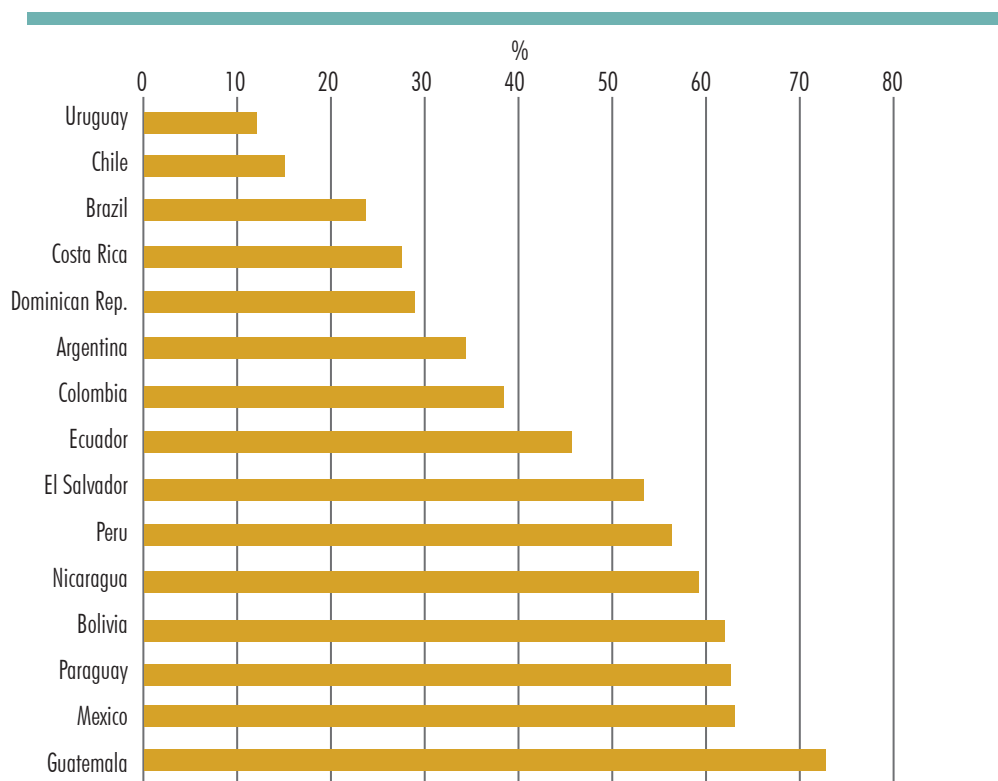
This chapter will describe and analyse the measure to introduce mandatory contributions for the self-employed in the context of the 2008 Pension reform, which consisted of a comprehensive package to improve coverage adequacy and efficiency in the Chilean Pension system. The next section will describe the labour market and provide a description of informal work, self-employed, and the target population for this measure. Section 3 describes the pension system and the 2008 reform. Section 4 will describe in detail the measures introduced to enforce mandatory contributions for the self-employed in Chile and in Section 5 we provide figures and an analysis of its impact. In section 6 we draw conclusions and policy recommendations from this experience.

CHILE'S PENSION INCLUSION CHALLENGES

Chile has one of the lowest rates of informal work in Latin America. Figures from the SEDLAC database show that Chile has the second lowest percentage of workers in the informal sector in the region, defined as those who do not have the right to a pension when they retire because they are not contributing to a pension system.²

² Rofman and Oliveri (2012) also show that this pattern is consistent within the region.

Figure 7.1
Percentage of workers in informal jobs (2013-2014)

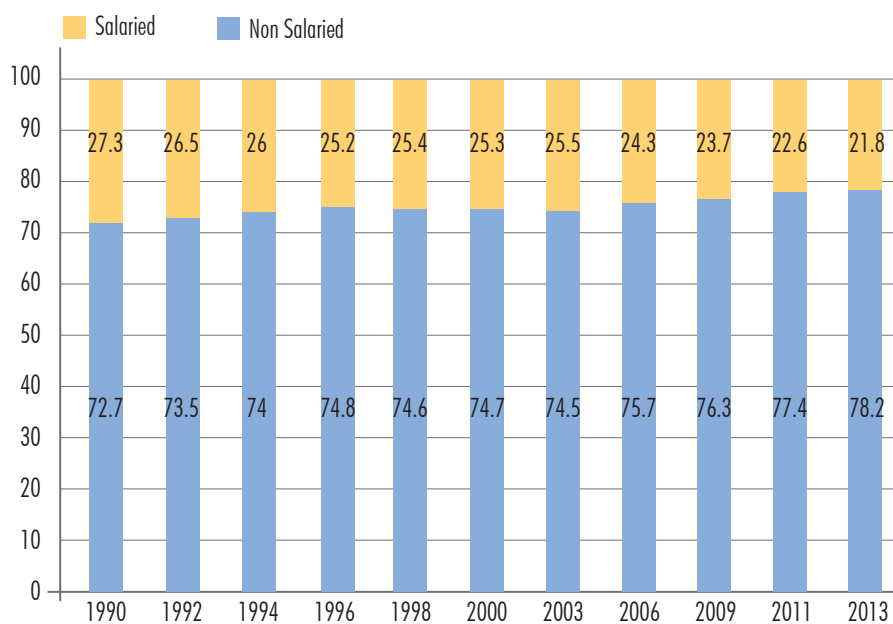


Source: SEDLAC (CEDLAS and The World Bank)

Despite the low rate of informality, there is still a substantial proportion of the employed population that is self-employed or working under other non-formal arrangements. As per the National Labour Market Survey, more than 20% of workers are non-salaried. Although this proportion has decreased over time, it still constitutes an important part of the labour market.

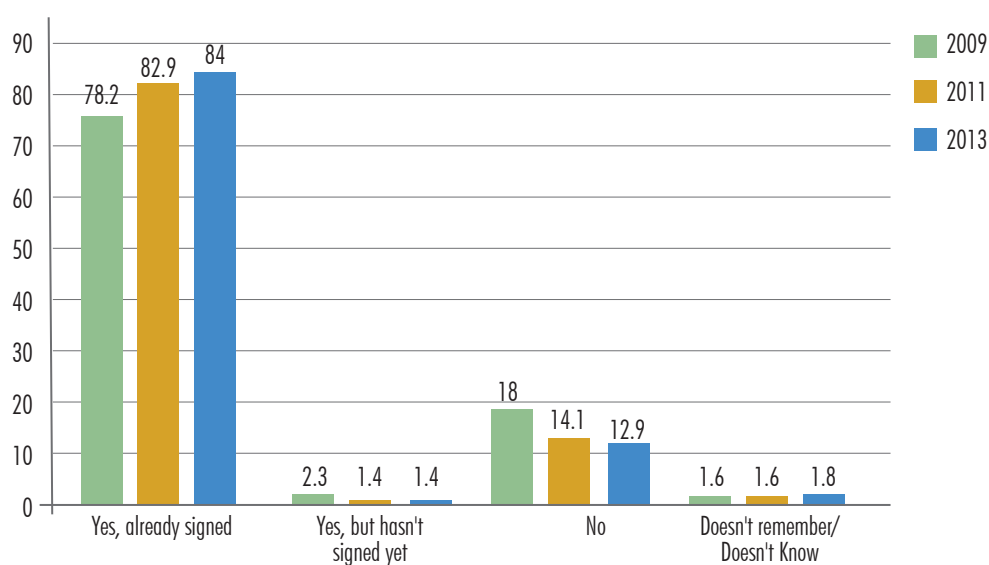
Among salaried workers, the vast majority have signed employment contracts, with less than 13% stating that they have not signed contracts. Therefore, the salaried portion of the labour market is significantly formal and should be covered by the mandatory contributory pension system.

Figure 7.2

Distribution of employment among salaried and non-salaried employees

Source: Ministerio de Desarrollo Social, CASEN 2009 - 2013

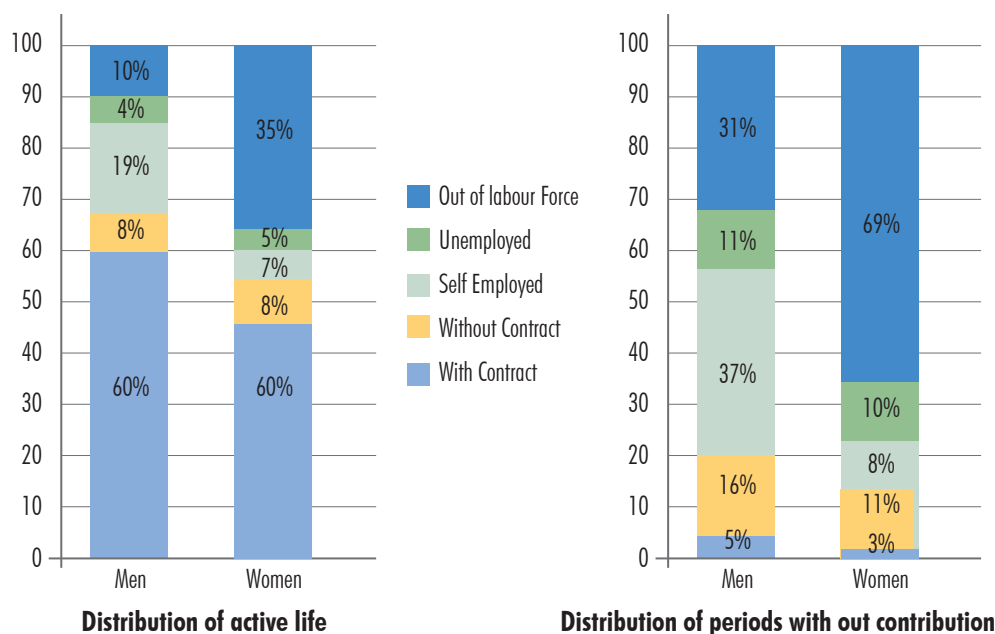
Figure 7.3

Salaried workers by contractual situation

Source: Ministerio de Desarrollo Social, CASEN 2009 - 2013

An analysis of lifetime labour histories contained in the 2002 Social Protection Survey carried out by Bernstein et.al (2006) indicated that while men spent on average 60% of their active lives working as salaried employees with contracts and 19% as self-employed, the corresponding figures for women were 46% and 7% respectively. It was seen that when men were mainly self-employed they did not make contributions, explaining 37% of the periods with no contribution. In the case of women, it only explains 8% of the periods with no contributions by them. The main reason for periods with no contributions for women is that they are not part of the labour force (69% of the time with no contributions).

Figure 7.4
Distribution of labour history by occupational status



Source: Bernstein, Reyes and Pino (2006)

For a sustainable pension system based on individual accounts, the key question that arises is whether the proportion of self-employed workers represents a core part of the population or not. And further, does that core have access to salaried and covered employment or are these workers shifting between covered and uncovered jobs, since the policy responses for either option are quite different. While some sort of alternative coverage arrangement would be necessary in the first case, initiatives to expand coverage of the existing pension system would be more effective in the second case.

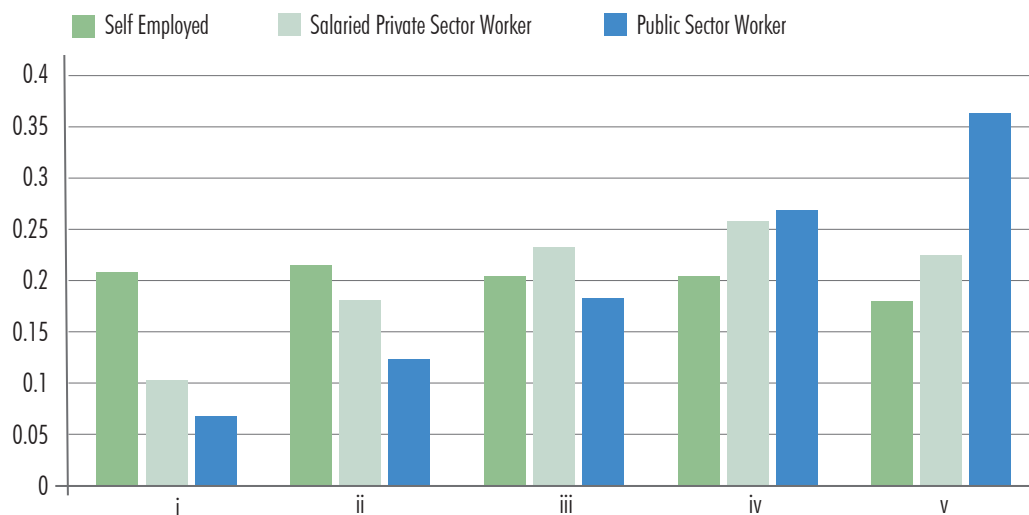
There is evidence that suggests that a majority of self-employed workers are people transitioning between formal and informal jobs. In addition, some self-employed workers also hold salaried jobs at the same time. Several studies have documented high labour rotation in Chile (Pérez 2009a, 2009b; Gatica and Romaguera, 2005). According to a

longitudinal study carried out by Mauro and Yáñez (2005: 17) over 10 years (1993-2002) about 68% of workers had at least one experience of change in their labour situation and about 23% had experienced three changes in their employment status over 10 years. Henríquez and Uribe-Echeverría (2004: 30-31) show that the quarterly mobility of employment condition (passing during the quarter between employed, unemployed or inactive) is around 9% and mobility by occupational category (change in a quarter between being an employee, self-employed, employer, etc.) is 5% for a total 14% mobility within a quarter. Data from Bravo (2008) using the EPS 2006 show that 8.9% of workers are individuals who have spent their entire careers being self-employed, while the proportion of workers who have been both self-employed and salaried employees is 22.8%. In other words, rather than thinking of the self-employed and wage earners as two separate populations, it is necessary to analyse them as two states between which people move.

Another relevant aspect of the pension policy targeting the uncovered group is their position in the income distribution of the country. According to the household survey CASEN 2015, 20% of self-employed workers belong to households in the bottom quintile of income distribution, compared with 10% for salaried workers in the private sector and 6% for workers in the public sector.

Figure 7.5

Distribution of workers by household income quintile and occupational category



Source: Ministerio de Desarrollo Social, CASEN 2015

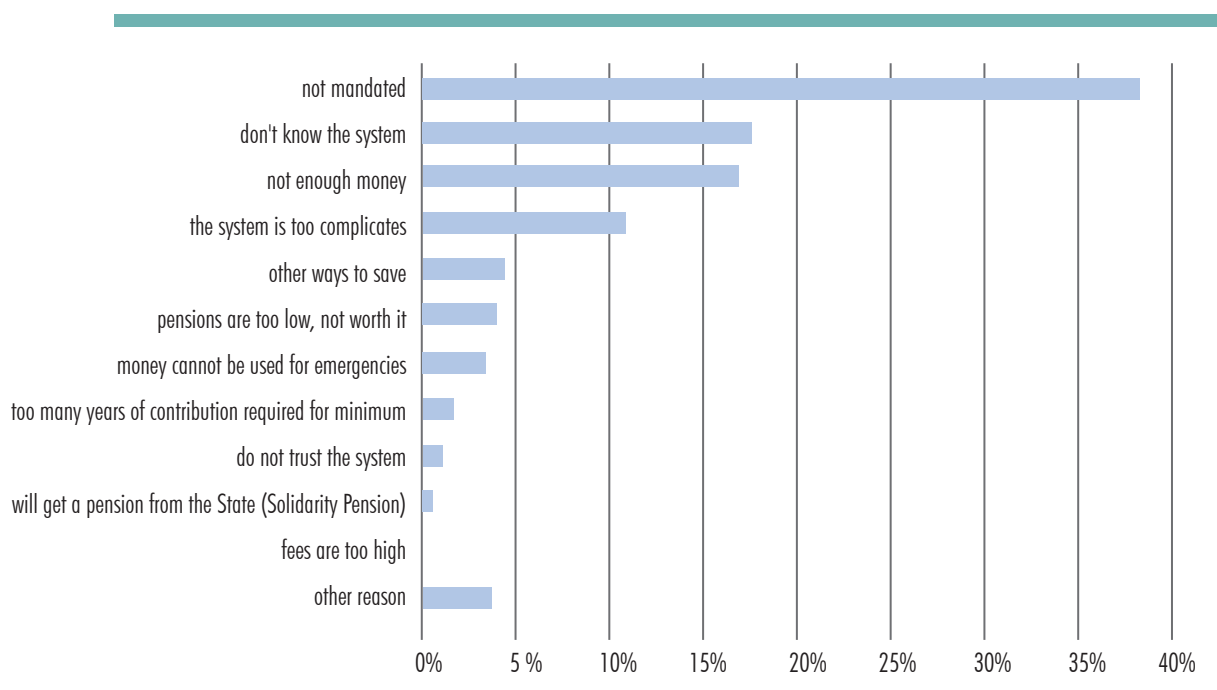
However, among the self-employed, the portion that provide service receipts is more concentrated in the top income quintiles. Forty seven percent of the self-employed who issue income receipts belong to households in the top income quintile, compared with only 11% of the self-employed who do not issue receipts (and therefore do not declare labour income taxes). On one hand, this finding suggests that a policy that uses the tax

declaration process to collect pension contributions would not be effective in capturing the lower income portion of the self-employed. On the other, this policy would be effective in mandating contributions from those who presumably have a saving capacity but do not exercise it because it is not mandated. This portion of the self-employed could potentially become a burden to the state if they end up qualifying for the non-contributory pension pillar, which became much more generous after the 2008 reform. Therefore, in the context of the overall reform, it makes sense to demand individual contributions from anyone who has the capacity to save, irrespective of their occupational category.

In the Social Protection Survey of 2009, 68% of the self-employed declared that they are not making pension contributions. When asked to explain this stance, 38% mentioned that they did not contribute because it was not mandated, whereas 18% each cited “lack of knowledge of the system” and “not enough money” as their reasons for the same. This is additional evidence that suggests that introducing mandatory contributions is an appropriate way of including the self-employed, with the capacity to save, into the pension system.

Figure 7.6

Main Reasons for Self Employed Not to Contribute to Pension System



Source: SEDLAC (CEDLAS and The World Bank)

This overview of the labour market in Chile suggests a series of challenges for increasing pension coverage. Although informal labour is not extensive, there is significant mobility between informal and formal sectors, generating periods without contributions that have a detrimental effect for many in a pension system based on individual savings. A relevant

part of these periods is explained by self-employed workers that have a savings capacity but do not use existing mechanisms to contribute voluntarily to the pension system. While increasing pension coverage and adequacy in the Chilean system requires a series of measures, a mechanism to include the self-employed in the mandate to contribute is certainly part of that package.

THE 2008 CHILEAN PENSION REFORM

As soon as a new Government took office in 2006, a Presidential Advisory Committee was formed with the mandate of producing a reform package that would improve coverage, adequacy and equity, reduce costs and increase returns in the pension system. The Committee produced a report containing a package of measures that included:

- Creation of a “Solidarity Pillar” that would provide non-contributory pensions for individuals without pension savings and a complementary subsidy for low pension amounts.
- Extension of the mandate to contribute for self-employed workers, along with access to the benefits in the system, such as disability insurance and family allowance.
- Introduction of contribution subsidies for workers entering the labour force and a compensatory bonus for women for the birth of each child.
- Introduction of gender equity measures such as eligibility for survivor’s pensions, separation of disability insurance cost by gender and use of unisex mortality tables.
- Introduction of Collective Voluntary Savings Plans.

Based on these recommendations, the government issued a legal amendment that was approved by Parliament in 2008 and it started being implemented in March the same year. Among the most important measures, and the earliest to be introduced, was the creation of the “solidarity pillar”. This pillar replaced both the existing, means-tested Assistance Pension, and the minimum pension guarantee imbedded in the funded pillar, which required a minimum of 20 years of contributions.

The solidarity pillar consists of two benefits that are related. First, there is a basic solidarity pension, “Pensión Básica Solidaria” (PBS), that provides a benefit to those aged 65 years or older who do not receive a funded pension and belong to the 60% poorest households of the population. Second, there is a solidarity pension subsidy, “Aporte Previsional Solidario” (APS), that provides a complement to low funded pensions of those in the 60% poorest households. The subsidy is reduced as the amount of the funded pension increases, but at a rate that is lower than one for one, in order to maintain incentives to contribute to the funded scheme. Hence, the total amount of pension would always increase as the individuals contribute. Therefore, the APS is calculated as a linear relationship between the PBS and a maximum pension amount eligible for the subsidy as in the following formula

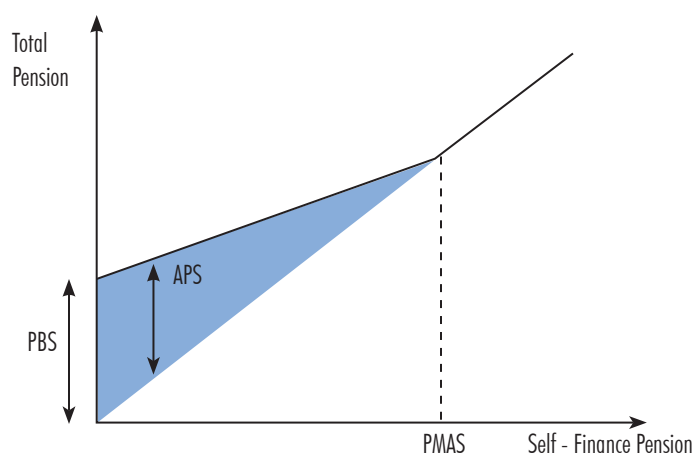
$$APS = PBS \left(1 - \frac{PB}{PMAS} \right)$$

where APS is the Solidarity Subsidy, PBS is the Basic Solidarity Pension, PB is the Pension calculated based on the individual's account balance and PMAS is the Maximum Pension that qualifies for the subsidy.

In graphic terms, the relationship between APS and the funded pension is as follows.

Figure 7.7

The New Design of the Chilean Solidarity Pension System



The introduction of the solidarity pillar was a measure to increase coverage and provide a response to the situation of those who had inadequate or no pensions and were not poor enough to qualify for the few available Assistance Pensions or had not contributed enough years to benefit from the minimum pension guarantee. It effectively replaced a basic state pension and created a more harmonized system.

However, this extension of coverage and generosity of the non-contributory part of the pension system made it important to strengthen the incentives and the requirements to contribute into the funded part of the system. Otherwise, if incentives were not strong enough, individuals could reduce their contribution efforts and rely solely on the solidarity benefits and the premise of potential future increases of those benefits. This is one of the main reasons for the design of the Solidarity Pillar in the first place: A flat benefit that only guarantees a minimum pension would have been cheaper for the government, but would provide no incentive, to contribute, to those who expect to finance low pensions. The introduction of the “clawback” design increases the cost, but maintains some incentives to contribute. However, the design per se is probably not enough and other complementary measures are needed to strengthen the coverage of the contributory pension system.

One of the areas of weak coverage identified in the diagnosis was the relatively low participation of the youth in formal employment. It seems that, although formal employment is high in Chile compared with other countries in the region, the transition of the youth from school to work leads to longer than average unemployment periods, high turnover, and higher incidence of informal employment.³ This has consequences for pension levels in a system based on individual capitalization, since early contributions play an important role in the total balance at the end of a working life due to compounding returns. In addition, there appears to be inertia in labour mobility, where formal employees are more likely to remain formal, while informal workers are less likely to transfer to formal jobs. For these reasons, early inclusion of young workers into the contributory system is very important.

The package of measures in the 2008 pension reform included a contribution subsidy for young workers. The subsidy would cover 50% of worker's contributions calculated over the minimum salary for workers that earn up to 1.5 times the minimum wage. This subsidy would be given for the first 24 months that the worker contributes to the pension fund. The subsidy would cover workers between 18 and 35 years of age who are making their first contributions to the pension system.

Prior to the 2008 reform, the self-employed were not mandated to contribute. This was another reason for the lack of coverage because very few of the self-employed made voluntary contributions. The aim of increasing contributions from the self-employed was clear, but there were important deliberations within the Advisory Committee on how to design and implement this new feature. One option discussed was to increase incentives and introduce some kind of subsidy. However, international evidence shows that those type of incentives are not very cost-effective.⁴ Another option considered was to learn from the international experience and use "soft compulsion", which meant the self-employed would have to make an effort to avoid paying contributions and replace the current situation in which the default is not paying and the effort should be made if the individual wants to contribute.⁵ However, such a mechanism would require a "contact point" with the self-employed which would be no different than introducing a simple mandate. In the end, the argument prevailed that if the non-contributory scheme became much more generous, then the contributory system should require a proportional effort to make contributions from all those who have some savings capacity, including the self-employed, to avoid a moral hazard problem.

As we saw in the analysis, there are many types of self-employed workers, with differing degrees of formality. The 2008 reform extended the mandate to contribute to a specific set of self-employed workers. As it happens, in the Chilean tax code, the individuals who provide professional services to a third party (but are not in an employer-employee relationship) have to register with the tax authority and issue invoices for those services.

³ See Fajnzylber & Plaza

⁴ See Hinz et.al (2013)

⁵ See Bernstein, Reyes and Pino (2006) for the proposal.

Upon submitting the invoice, the individual is paid, but the party that hired the services retains 10% of the payment to remit as a provisional tax payment to the Internal Revenue Service (SII). At the end of the fiscal year, the individual needs to file a tax declaration and, according to this, the 10% retention can be used to discount from any taxes that liability or it is returned to the individual if he or she falls into a tax-exempt income category.

Therefore, this group represents a portion of the self-employed who are relatively formal and for which the mandate to contribute could be implemented with relative ease, by adapting the existing procedures carried out by the SII. Nonetheless, this mechanism would cover only a portion of the self-employed, while those who are completely informal, with no tax registration, would fall outside the reach of this mechanism. However, the introduction of this measure provides an example of how existing administrative procedures can be adapted to reach a portion of the population that has some degree of “contact” with the government apparatus but who had not been previously included in the pension system. The next section of the chapter discusses in detail the design and implementation of the mechanism that allows self-employed individuals to make pension contributions through their annual tax returns.

MANDATORY CONTRIBUTIONS BY CHILE'S SELF-EMPLOYED

Once the decision to introduce mandatory contributions, for the self-employed using the annual tax return process, was taken, the actual structure had to incorporate several details in terms of its operation and coverage, as well as benefits to be provided to those making contributions.

In the first place, the traditional contributions to pension funds (both mandatory and voluntary) are monthly, while the new contribution system would be on an annual basis. This has implications in terms of the contribution ceiling and the coverage of disability and survivor's insurance.

Second, the contribution is traditionally paid directly to the Pension Fund Manager, ‘Administradora de Fondo de Pensiones’ (AFP), or using existing collection mechanisms, such as banks or the online portal ‘Previred’. In this case contributions would be paid through the SII, which had not previously participated as a collection agent in the system. However, the SII had already a well-established track record of utilizing optimally an online process of tax declaration and collection from the self-employed. The same process was used for collection of social insurance contributions. Since SII would collect money that was destined for the individual pension account of a contributor, a communication mechanism had to be established between SII and the AFPs to transfer the funds.

A third issue that came to light related to cases where individuals had worked both as formal employees and were self-employed in the same year. Once again, in this case, the

contribution ceiling and coverage of disability and survivor's insurance needed to be adjusted.

This section describes the tax payment process, coverage, benefits, and implementation of this measure.

COVERAGE

The groups mandated to contribute are individuals who receive payments for activities carried out as self-employed workers and who provide a receipt for those activities or receive rents for participation in Professional Societies.⁶ These are specific areas of work of income earners that are classified under Chilean tax law. Members of the old pension system that never transferred to the individual capitalization system and members that are less than 10 years away from retirement age (women above 50 and men above 55) are exempted from the obligation to contribute. Individuals who have already contributed up to the maximum ceiling of contributions through the year and those who have received less than the equivalent minimum salary for the year are also exempted from contribution.

BENEFITS

The benefits provided for the contribution include savings towards old age pensions, coverage for survivors and disability pensions, coverage for worker's compensation benefits (work-related accidents and professional health) and other benefits such as family allowance and eligibility for membership in "*Cajas de Compensación*", which are non-profit private social security institutions that provide credit, savings, and other benefits to their members.

In the case of annual contributions made by self-employed workers, the coverage of a disability and survivor's insurance was tagged to the amount of the contribution as follows:

- If the contribution is made for an annual taxable income that is equivalent to at least seven times the monthly minimum income, coverage will be provided for a full year starting 01 May of the year when contributions were paid up to 30 April of the following year.
- If the amount of the contribution is made for an annual taxable income that is less than the equivalent of seven minimum monthly incomes, the period of coverage will be proportional to the ratio between the annual taxable income and the minimum income.

CONTRIBUTION COLLECTION MECHANISM

The process for collecting contributions from the self-employed utilizes the existing procedure of the annual tax declaration. This procedure is available online on the SII website (<http://www.sii.cl>). In Chile, the Tax Identification number coincides with the national identity number and therefore each individual has such a number assigned at

⁶ A Professional Society is an association of individuals that is constituted for the common exercise of a professional activity as established by the Law.

birth. The self-employed must register their “initiation of activities” with the SII for the person to be able to provide service receipts (*boleta de honorarios*). This is an online process that allows individuals to obtain and issue these invoices. Most of the self-employed covered by the introduction of pension contributions have already initiated their activities, as they need to have completed this step in order to issue receipts and subsequently present their tax declaration. Throughout the year, each time a self-employed worker is paid for services provided to a third party, the individual issues a receipt and is paid the agreed compensation for the service provided. The payer retains 10% of the payment and declares and pays it to the SII within the first 12 days of the month following payment to the individual. The self-employed individual has until the following April to declare all income received in the previous year. This annual tax declaration process is online and uses the individual Tax Identification Number (TIN) plus a secret password provided by SII to identify the contributor. Information on all rents, sources of income, provisional payments and deductions is filed using an online form. Since the individual has issued electronic receipts and retentions, and as payments have been made on his or her behalf online throughout the year, most of the information is usually pre-populated in the tax declaration form. This eases the overhead for an individual contributor, who usually needs to only review and confirm that the pre-populated information is accurate. Once this information is confirmed, the system automatically calculates the deductions, comes up with the annual taxable income, applies the contribution rate, and calculates any remaining tax debt or credit owed by or to the contributor. It then processes the payment to the contributor (in case a tax refund is owed) and to the Treasury, which in turn transfers the contribution resources to the corresponding AFP through established electronic collection mechanisms.

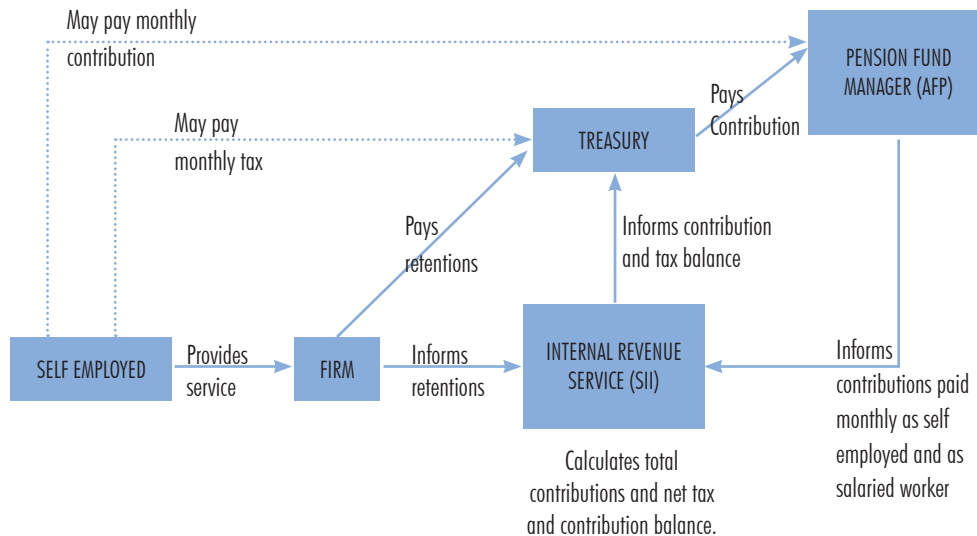
In the eventuality that a self-employed person makes monthly contributions on a voluntary basis or if the individual also has a salaried job during the year, the AFP must inform the SII about these contributions and the SII will take them into consideration when calculating the net pension contribution owed by the individual.

If a self-employed individual is not yet a member of any AFP, the first contribution constitutes his or her affiliation with the system and the self-employed person is required to join the AFP that has earned the right to manage the funds for all new members through the bidding process established under the 2008 pension reform.⁷ As a result, a new member joins the cheapest AFP in the market.

The contribution process using the annual tax declaration is schematically represented in Figure 7.8.

⁷ In order to increase competition and price sensitivity in the AFP market, the 2008 Pension Reform introduced a bidding process mechanism under which all new members of the system would be assigned to the AFP that offered the lowest management fee for a period of two years, without the possibility of changing AFPs during that period. Three bidding processes have taken place so far, resulting in a new participant in the market and a reduction of fees from an average level of 1.65% of contributory salary to 1.16% net of the disability and survivor's insurance premium.

Figure 7.8
Tax declaration process



Source: Pensions Supervisor Presentation, "Self-employed workers", Pension System Talks series, 2014.

CONTRIBUTION AMOUNT

The contribution base for self-employed is determined based on the annual taxable income that is indicated by an individual in his or her tax declaration. In Chile, 70% of the annual income from rents and compensations is considered for computing the tax liability of a self-employed individual. Self-employed individuals are allowed a 30% deduction⁸ on expenses including the cost of materials, transportation, etc. A contribution to a pension fund would therefore be 10% of this annual taxable income. On top of that contribution, a self-employed person would be required to also pay the fees charged by the AFP for managing the individual pension account, the premium for disability and survivor's insurance effective at the time of the contribution, and the contribution for the worker's compensation (0.9% plus a premium depending on the activity). Starting 2018, a contribution of 7% of the annual taxable income toward health insurance would become mandatory.

TRANSITION PERIOD

Policy makers recognized that mandatory contributions by the self-employed would cause a major change in the design and functioning of the pension system. A transition period was therefore introduced. For the first three years after approval of the reform, the mechanism to make annual contributions with personal tax declarations would not be introduced, but an information campaign and sensitisation activities would be launched

⁸ The deduction is capped at USD 12,000 approximately.

to inform the self-employed of the upcoming introduction of mandatory pension contributions. After this initial period, a second period of three years would be used to implement the measure gradually (which is similar to the phasing approach used in both the U.K. and Turkey's auto-enrolment reforms discussed in Chapter 3 and Chapter 5). The gradual implementation would consist of two actions:

- A gradual increase of the annual contributory income. In the first year of implementation, the base salary for calculating the contribution would be equivalent to 40% of the annual taxable income, increasing to 70% the second year to reach 100% by year three.
- The possibility to waive the contribution (soft compulsion). During the three-year period, a self-employed individual would have a chance to opt out of the pension contribution. To this effect, the individual would need to submit a sworn declaration through the SII website prior to filing his or her annual tax declaration. If the sworn declaration for opting out of the pension contribution was not filed, the pension contribution would be automatically calculated and processed with the tax declaration form, without the option of opting out at that point. This process is to be repeated each year as the declaration is only valid for the same year in which the income tax is declared. Therefore, during the 3 year period, while an individual could still choose to not make a contribution, the default mechanism would automatically kick in and require a pension contribution through the annual income tax filing process if the sworn declaration was not filed during the financial year.

Although in the original design, this transition period was to be in effect between 2012 and 2014, with the first year of mandatory contributions effective in 2015, the Chilean Parliament has postponed the implementation of mandatory contributions to 2018, together with the compulsory health insurance contribution that would become effective in that year. Therefore, what is currently in effect is the semi-mandatory 10% contribution rate for pensions calculated on the total annual taxable income for a self-employed individual. The results of this three-transition period will be discussed in the next section.

OUTCOMES

THE FIRST FOUR YEARS

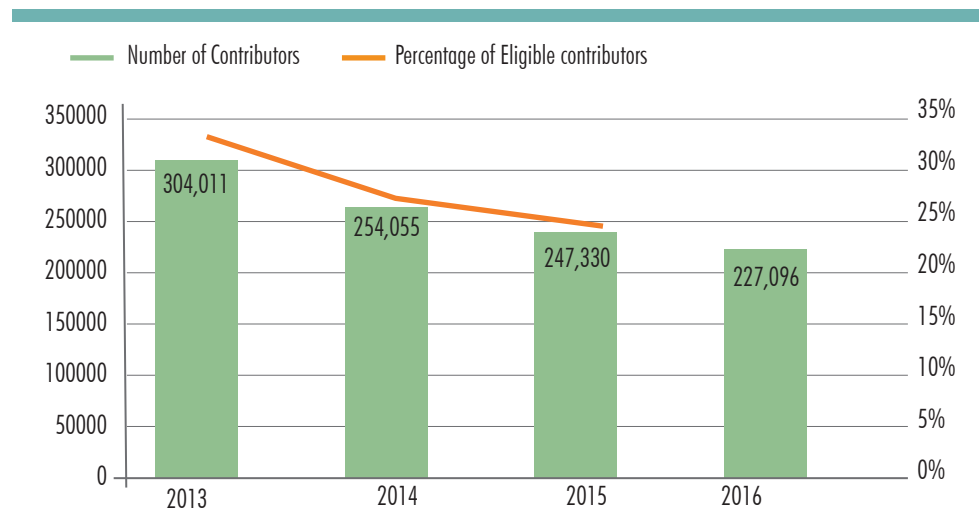
In the first year of implementation of this measure, more than 300,000 self-employed individuals contributed through the system, which represented 33% of those eligible to contribute. This was seen as a significant improvement compared to the typical figure of around 100,000 self-employed that contributed on a monthly basis during 2012. However, both the absolute number of annual contributors and the proportion of those who opt to contribute, have declined over the years.

The total number of self-employed contributors in the last tax declaration process (April 2016) has declined to 227,096 while the proportion of individuals who have waived

contributions has gone up from 70% in 2013 to 75% in 2015. The value of contributions has increased during this period largely because the 10% contribution rate in the first year was calculated on 40% of the annual taxable income whereas the base income used for calculating the pension contribution was increased to 70% in the second year and to 100% in the third year. In addition, workers may have become more familiar with the contribution mechanism and more aware of the option to waive contributions, especially since it was announced that the implementation of fully mandatory contributions would be postponed, first by one year and then until 2018.

Figure 7.9

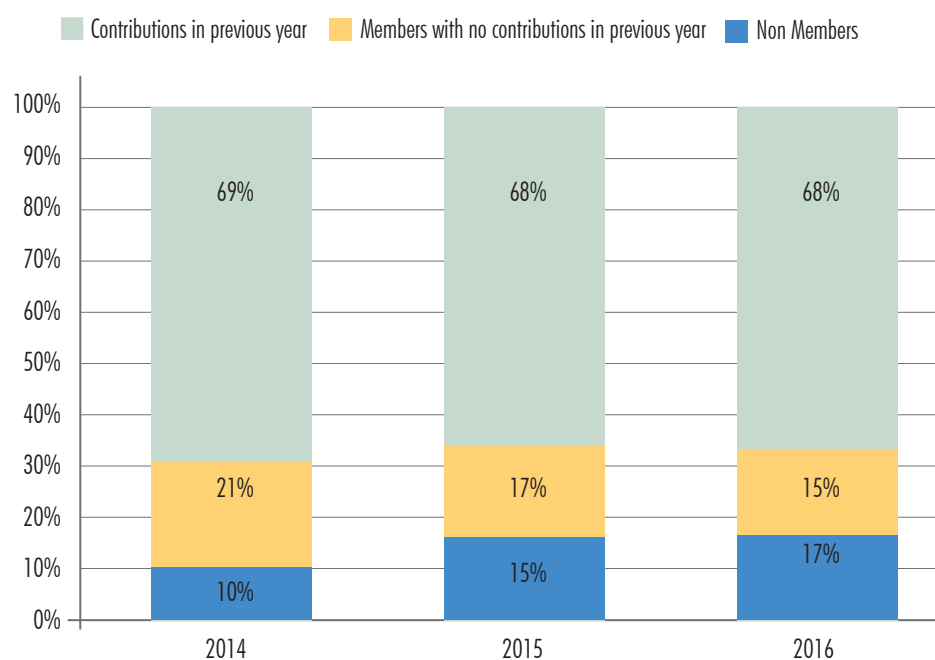
Total Number of contributors and effectiveness of default contribution mechanism



Source: Superintendencia de Pensiones "Seguimiento Reforma Previsional" various reports: 2013-2016

The Pensions Supervisor in Chile has produced a biannual report that follows up the implementation of the 2008 pension reform. This report contains a breakdown of the self-employed that have used the annual contribution mechanism through the tax declaration process. The majority of the effect seems to have come at the intensive margin, i.e. increasing the amount of contributions for the self-employed who were already members of the pension system and had made some contributions in the previous year. The number of new members who entered the system through this mechanism (extensive margin) represents around 14% of total contributors over the first three years of implementation.

Figure 7.10

Distribution of Annual Contributors by contributory status in the Pension System

Source: Superintendencia de Pensiones "Seguimiento Reforma Previsional" various reports: 2013-2016

The results from the first few years of implementation, using a soft compulsion mechanism through default contributions with an opt-out option suggest that this measure had a stronger impact on increasing savings from existing participants rather than attracting new participants into the system. It may well be the case that the proposed fully mandatory contributions shall have a stronger impact on the extensive margin. However, as it stands, this measure will ultimately have a more important impact on the adequacy of pensions (by increasing saving accumulations and density of contributions) than on coverage.

LESSONS LEARNED

Chile implemented a mechanism to collect pension contributions through the annual tax declaration process as part of a comprehensive pension reform approved in 2008. As such, this measure is better understood as part of a reform package that aimed at increasing coverage by both increasing the generosity of the non-contributory pillar and strengthening the outreach of the contributory pillar.

There are several specific circumstances that other countries should take into account when examining the Chilean case of introducing mandatory (or semi-mandatory) contributions for the self-employed. At heart, it is a measure to include people who are currently outside the pension system because the mandate does not extend to them. However, the inclusion of the self-employed in the case of Chile has resulted in increased contributions by individuals who are already members of the system, including those who earn both salaried and non-salaried income (as self-employed individuals). This is the case for the self-employed who are either transitioning between salaried jobs or self-employed activities or who work as self-employed workers in addition to their salaried jobs. The result would perhaps be different in countries with a clearer segmentation in the labour market between self-employed and salaried workers.

The focus on self-employed activities that are visible to tax authorities resulted in a positive impact on increasing contributions from a section of workers who are relatively formal and have the capacity to save. While this has helped improve pension coverage and contributions by the middle class, it has not had any significant impact on expanding coverage to the low income informal workers.

Finally, it is important to note that there was an enabling environment that facilitated the implementation of this measure in the case of Chile. The individual capitalization pension system had been in place for more than 25 years. There was a clearly established regulation of activities carried out by self-employed individuals in the tax code, extensive use of such regulation by self-employed individuals (more than 1 million annual tax declarations out of an estimated universe of around 1.6 million total self-employed), and an existing unique national ID that enables matching the information between pension contributions and tax declarations. All these aspects meant that a mechanism for pension contributions using the annual tax declaration could be implemented with relatively minor changes. In other circumstances, the creation and use of national IDs, establishing online payment mechanisms, and so on can be important hurdles that should be addressed before such a mechanism is implemented. It also highlights the benefits of leveraging an existing infrastructure, that is already being used for a core function, to deliver another important policy – thereby improving the efficiency of both operations.

Table 7.1

Summary of key features and consequences in the case of Chile

Specific Feature observed in the case of Chile	Consequence for Pension Inclusion
High labour mobility between formal salaried, self-employed, and informal jobs.	New contributions by the self-employed mostly from current members of the system who were not contributing fully.
Target population is a subset of the self-employed who declare taxes.	Contributions by a section of the self-employed that is relatively more formal and has higher incomes and savings capacity (through not from low income informal workers).
Measure is part of a comprehensive reform package.	Relevant to understand the interaction with other measures, such as the new solidarity pillar and enrolment of new members in the lowest cost fund manager. Such a measure on its own may not be enough to increase coverage and adequacy.
Use of an existing platform and procedures for annual tax declaration and comprehensive use of national ID.	An existing mechanism needed to be adapted for collection of pension contributions by the Internal Revenue Service. However, no new mechanism needed to be developed from scratch. A strong track record on the use of national IDs also helps implementation of such a measure.
Use of existing regulation of self-employed activities and their tax treatment.	The existing regulatory framework provided a clear definition of the self-employed individuals who would be affected by the introduction of mandatory pension contributions. This also provided a basis for developing the mechanism and defining the target population for such a measure.

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