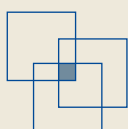


## NOTES ON FORMALIZATION

# Slight decline and key challenges in informal employment in Paraguay

Paraguay has recorded a slight but ongoing reduction in informal employment in recent years as a result of institutional-strengthening policies that expanded pension coverage. This achievement, together with the promotion of robust, stable growth and advances in reducing production gaps, are essential for achieving significant, sustainable improvements.



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## Foreword

Informal employment is a persistent problem in Latin America and the Caribbean. Following a decade of economic growth and decline in unemployment rates, there are still 130 million workers holding informal jobs, deprived of social protection and labour rights.

This does not mean, however, that there has not been any progress made on the issue of formalization.

Formal employment, wage labour and social protection coverage have increased in Latin America and the Caribbean. Now, it is important to speed up this process to confront the long-time growth and consolidation of informality in the region.

We cannot forget that the reduction of informality is a key component of the efforts to reduce inequality and social exclusion.

The experience of the last few years confirms that economic growth is essential for the generation of more and better jobs, but it is not enough. To reduce informality, it is necessary to implement deliberate and integrated economic, social and labour policies and actions that complement economic growth, in the framework of sustainable development.

In fact, the policies implemented in several countries were key components of the progress achieved on the subject of formalization. This formalization process has not been uniform. In some countries, processes were faster and took a relatively short time. In others, progress has been slower.

In 2013, the ILO Regional Office for Latin America and the Caribbean launched the **Programme for the Promotion of Formalization in Latin America and the Caribbean, FORLAC**. The programme has three components: a) generation and dissemination of knowledge on formalization policies, b) technical assistance to specific countries, and c) capacity-building of workers' and employers' organizations in formalization issues.

The ILO FORLAC Notes presented here are part of the first component. We analyze public policy experiences trying to identify the most remarkable ones according to the academic or political discussion.

Formalization strategies require a favourable economic context, as well as articulated policies that allow us to address a multidimensional and highly heterogeneous phenomenon.

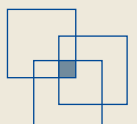
The persistence of high levels of informality is a major challenge requiring the implementation of measures that produce sustainable results.

The ILO expects that the dissemination of these experiences will help promote broader discussion on the strategies that countries may use to facilitate the transition to formality in the region.

Elizabeth Tinoco  
ADG

Regional Director of the ILO  
for Latin America and the Caribbean

Regional Office  
for Latin America  
and the Caribbean



## 1. Economic context and volatile growth

Following two “lost decades” between the 1980s and 1990s, GDP began to grow at a moderate pace with many fluctuations in 2003. In the period 2003-2011, the annual average growth rate was 4.1%, with a variation ranging from 2.1% in 2005 to 13.1% in 2010,<sup>1</sup> following the global financial crisis in which the Paraguayan economy contracted by -4.0%. Economic fluctuations reduce predictability, which in turn affects economic activity and thus the capacity of the market to generate quality employment<sup>2</sup> (ECLAC, 2011).

Volatility mainly results from two factors removed from economic policy: the climate and dependence on external conditions. The important weight of agricultural production in GDP, combined with limited diversification, make inclement weather a relevant variable for economic performance. The decline and subsequent economic recovery between 2009 and 2010 was the result, first, of a prolonged drought, and second, of beneficial rains.

The second relevant variable to explain volatility is the economic performance of neighbouring countries (MERCOSUR), given the size of the Paraguayan economy in comparison with those countries and the important opening of the economy to the exterior. This means that fluctuations in neighbouring economies have a rapid impact on the Paraguayan economy.

Soy, wheat, sunflower and livestock are Paraguay’s main commodities and account for a large share of total exports. Over the past decade, these commodities performed well, due both to external conditions –rising international prices– and increasing productivity and production volumes on the domestic front. This dynamic has led the growth in the relative weight of agriculture in GDP, to the detriment of the secondary sector (manufacturing), which has been declining. The tertiary sector (services) experienced a slight increase in its relative participation in GDP.

Analyzing enterprises operating in Paraguay by size offers a greater understanding of labour market characteristics and the prevailing informality. The latest available data<sup>3</sup> indicate that over 60% of the employed population works independently or in enterprises with two to five workers. Fewer than 10% are employed in medium-sized and large enterprises (with more than 50 workers).

Enterprise size is clearly associated with retirement pension coverage: the larger the enterprise, the higher rate of coverage. In medium-sized and large enterprises (with more than 50 workers), over two-thirds of wage workers contribute to a retirement or pension system. This figure declines to a much lower 12% in the case of workers employed in enterprises with five or fewer workers.<sup>4</sup>

Thus, a productive infrastructure based on micro and small enterprises, with a concentration of agricultural exports of little added value –and which are highly vulnerable to weather conditions and the performance of neighbouring economies– along with a declining manufacturing sector, significantly limits the generation of quality employment, and consequently, the rapid decrease in informality in Paraguay. Informality has declined very slowly, despite several years of economic growth, as discussed in the following section.

1 Central Bank of Paraguay (2012). *Boletín de Cuentas Nacionales*. 2002-2011 Series. Base year, 1994. Asunción.

2 ECLAC (2011). *Economic Survey of Latin America and the Caribbean 2009-2010*. Santiago, Chile.

3 DGEEC (2012). Preliminary data. Ongoing Household Survey, 2012.

4 DGEEC (2012). *Boletín de empleo*. Ongoing Household Survey, 2012.

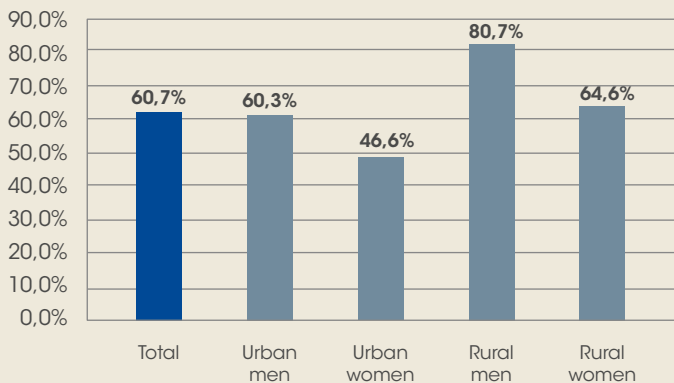
## 2. Informal employment in Paraguay

Informality, in all ways this phenomenon is measured, is a characteristic of the Paraguayan labour market structure. While there are different approaches for examining this issue, in this paper, informal employment is defined as the group of wage workers who do not have social security and, specifically, do not contribute to any retirement programme.

According to this definition, and using data provided by the 2011 Ongoing Household Survey –which found that just 39.3% of wage workers (excluding domestic workers) contributed to a retirement system–, informality affects 60.7% of these workers, as shown in Figure 1.

With respect to sex, the data show that women have a higher level of retirement pension coverage than do men (50.9% versus 33.9%). This reflects women's predominance in the tertiary sector, which includes employment in public sector institutions, especially education and health institutions. With regard to geographic location, the urban sector concentrates the largest share of wage workers with coverage (44.7% as compared with 22.6% for the rural sector).

**Figure 1: Paraguay. Informality in 2011 (In percentages of wage employment)**

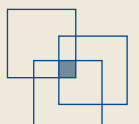


**Source:** ILO, based on the 2011 Ongoing Household Survey.

An analysis of trends in retirement system or pension coverage in the period 2007-2011 indicates a sustained improvement in terms of coverage (retirement) among wage workers. The positive change in that period is approximately one percentage point per year given that it increased from 34.1% in 2007 to 39.3% in 2011.<sup>5</sup>

This result is partially associated with the changes in the structure of employment. On the one hand, the increase in employment occurred in occupations with greater social security coverage and on the other, the main institution of the sector, the Social Protection Institute (IPS), stepped up efforts to improve coverage. In this sense, a decline was recorded in the relative weight of own-account work or that in microenterprises (from two to five workers). By contrast, employment in medium-sized and large enterprises (more than 50 workers) increased.

More than 80% of the increase in the number of workers with retirement pensions occurred in the tertiary sector, specifically in the areas of trade, restaurants and hotels and community, social and personal services. In this last area, work in the public sector is relevant as it reported an increase



<sup>5</sup> DGEEC (2012). *Boletín de empleo*. Ongoing Household Survey 2012.

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of nearly 30% between 2007 and 2011. The larger the enterprise, the higher the percentage of retirement pension coverage among wage workers employed there.<sup>6</sup>

The high level of rural informality is associated with the relative participation of work on small farms. The 2008 National Agricultural Census (CAN) estimated that in 2008, there were 235,000 farms of 20 or fewer hectares in the eastern region, and of 50 or fewer hectares in the western region. Household heads and the rest of the family work on these farms. The CAN found that some 680,000 people ages 15 years and over work on the farms.

Family farms had no social security coverage of any kind until August 2013, when a new law created the possibility of the voluntary incorporation of own-account workers in the Retirement and Pensions Funds of the IPS. This incorporation does not include medical care or assistance. However, the poverty conditions and vulnerability to climate that characterize farm families are expected to be obstacles for incorporation, since the cost of the contribution is equal to 13% of the minimum wage, the lowest floor of the contribution.<sup>7</sup>

Other recent studies<sup>8</sup> identify the level of key characteristics of informality and the difficulties the country faces in reducing it. The 2013 National Human Development Report discusses trends and the current situation in the informal economy, using three (non-exclusive) analytical categories: informal employment, informal sector and informal employment outside the informal sector and in the household. Informal employment (without retirement pensions) affected 81.3% of the employed population ages 15 years and over in 2011; employment in the informal sector –in production units with a maximum of five workers– was 62.9%; and informal employment outside the informal sector –in production units with six or more workers or in the household–, reached 21.3%. The highest level of informality is that which includes retirement or pension coverage as a relevant variable.<sup>9</sup>

No relevant differences by sex have been found with respect to informal employment: 81.8% of men have informal jobs, as compared with 80.6% of women. However, the gap widens to men's disadvantage when employment in the informal sector is analyzed. Nevertheless, when households are incorporated, the situation of women worsens given their concentration in domestic work, an occupation which does not have mechanisms to access any of the existing programmes.

**Table 1: Paraguay. Trends in the informal economy: 2001 and 2011 (In percentage of the employed population)**

	Total		Men		Women		Urban		Rural	
	2001	2011	2001	2011	2001	2011	2001	2011	2001	2011
Informal employment	87,1	81,3	87,5	81,8	86,5	80,6	80,5	73,4	95,3	93,2
- In the informal sector	67,5	62,9	71,1	66,1	61,8	58,4	54,0	50,8	84,3	81,3
- Outside of the informal sector	21,1	21,3	17,9	18,9	26,3	24,8	28,2	26,2	12,3	13,9

**Source:** UNDP/ILO (2013). National Human Development Report, Paraguay 2013. Decent Work and Human Development. Asunción.

<sup>6</sup> DGEEC (2012). *Boletín de empleo*. Ongoing Household Survey 2012.

<sup>7</sup> This contribution is equivalent to Gs. 208,000 (US\$ 47), the average amount paid to families living in extreme poverty that participate in the Tekoporá programme (conditional cash transfer programme) and to 59.0% of the value of the rural poverty line, below which 44.8% of the rural population live, according to information provided by DGEEC in the bulletin *Principales resultados de Pobreza y distribución del ingreso 2012*.

<sup>8</sup> UNDP, ILO (2013). Human Development Report. Decent Work and Human Development. Asunción. González, Cynthia (2010). "El empleo informal en el Paraguay: Evolución, características y consideraciones de políticas públicas." KAS, CADEP. Asunción. DGEEC (2012). *Boletín de empleo*. Ongoing Household Survey 2012.

<sup>9</sup> The ILO estimates that informal employment, as a proportion of non-agricultural employment, reached 65.8% in 2011, and that there is a downward trend in this area, decreasing from 70.7% in 2009 to 66.5% in 2012.

By geographical area, the rural sector is most affected by informal employment, with a rate of 93.2%, as compared with 73.4% for urban areas. In other words, employment in the informal sector affects eight out of 10 people in rural areas and five out of 10 in the urban sector. In both cases, informal employment is concentrated in the informal sector—in production units with a maximum of five workers—, although in urban areas, informal employment outside the informal sector has more weight (in production units of six or more workers or in households).

Over the past 10 years (2001-2011), informal employment in the informal sector has declined whereas that outside the informal sector has remained stable. At any rate, while the slow advances have managed to reduce the percentages of informality, they have not done so in absolute values since the population grew more rapidly. The improvement recorded affected the sexes equally, but in terms of area of residence, advances were concentrated in the urban sector.

In addition to workers' area of residence and sex, there are also inequalities in terms of socioeconomic level and age group. Informality affects youth and people living in poverty more than other groups on the one hand; and on the other, advances recorded in the study period (1997/1998-2008) were more beneficial to adult men and to individuals who were not poor.<sup>10</sup>

### 3. Factors associated with the decline in informal employment

Informality has declined slowly but steadily. While it is impossible to isolate the influence of economic growth—especially of the tertiary sector—it is possible to demonstrate that this decrease also was largely due to the combination of increased citizen demand for legislative changes that expanded coverage to excluded labour collectives, and the implementation of a new IPS management model in 2003. The IPS is the country's main social security institution. These three factors drove the increase in the number of new contributors to this institution's general plan.

Paraguay has eight social security institutions, although just two of them concentrate 92.4% of the insured population: the IPS (49.1%) and the fiscal fund (43.3%).<sup>11</sup> The others are the municipal, railway workers', banking, congressional, National Electricity Administration (ANDE) and Itaipú funds. The IPS was created to offer coverage to dependent private sector workers but in recent years has been incorporating public sector collectives (decentralized enterprises, municipalities, treasury workers). The IPS has several plans, the largest of which includes retirement/pension and health care coverage. However, there are still collectives, such as that of domestic workers, which only have the right to health benefits. Other funds include only retirement benefits and/or pensions.

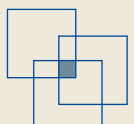
There are two problems with IPS retirement benefit coverage. First, it excludes important occupational categories, such as employers, own-account workers (who were included beginning in August 2013) and unpaid workers, domestic workers<sup>12</sup> and public workers (who are being progressively incorporated but with the option of the fiscal fund). Second, evasion is a problem in private sector employment, which in 2008 was estimated at about two-thirds of the total.<sup>13</sup>

<sup>10</sup> González, C. 2010. Op cit.

<sup>11</sup> Ibid.

<sup>12</sup> This exclusion is serious given that, according to the Ongoing Household Survey 2011, 37.1% of the employed population is composed of own-account workers; 12.2% are unpaid workers; 7.6% are domestic workers; and 5.8% are employers.

<sup>13</sup> Almada, Carmen Frutos de (2008). Workshop on the extension of social protection to agricultural workers, Belem do Pará (Brazil), 14-18 July 2008.



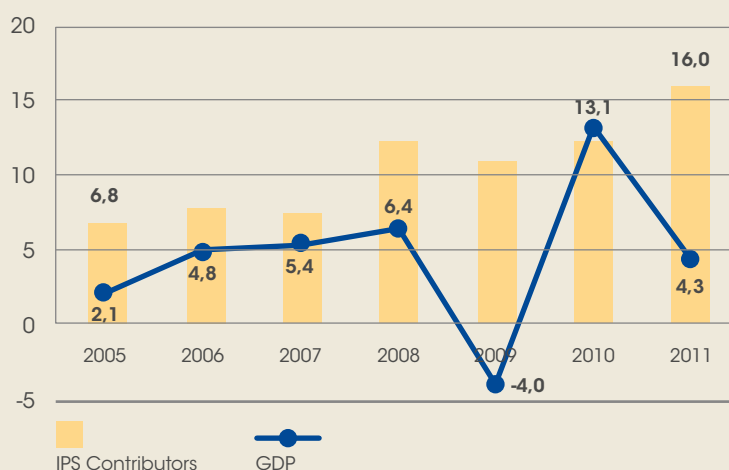
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In an effort to expand coverage, the IPS launched several institutional reforms in 2003. Almada and Ferreira<sup>14</sup> found that, based on this new model, institutional credibility increased and control improved, which made it possible to reduce evasion and at the same time increase coverage. This new model was based on five pillars: i) improve and modernize institutional management to achieve excellence in service delivery to contributors and beneficiaries; ii) expand social security coverage among the population; iii) strengthen the comprehensive development of skills and opportunities of human resources as key actors for achieving targets; iv) guarantee the generation of resources to ensure compliance of current and future obligations; and v) promote an administrative culture based on the values of honesty, transparency and equity through the example and commitment of IPS authorities.

An indicator of improved management, which may have increased confidence in the IPS among the citizenry, was the reduction of authorization periods for regular retirement benefits, from 750 days in 2003 to 31 days in May 2011. This decrease was made possible thanks to the digitalization of records and workers' payroll deductions since 1943.<sup>15</sup>

Moreover, after regulatory reforms were made, both legislative as well as within the IPS – as a result of demands by labour collectives and public policy–, new contributors were included in the Retirement and Pension Fund, such as longshoremen, employees of the Attorney General's Office, private schoolteachers and artists.<sup>16</sup> In 2002, the number of social security contributors declined as compared with the previous year; by contrast, beginning in 2003, the number of new contributors rose 12% annually. Between 2004 and 2011, the number of IPS contributors increased from 200,492 to 401,652, whereas the number of individuals with social protection rose from 584,320 to 1,124,753.<sup>17</sup>

**Figure 2: Trends in GDP growth and IPS coverage: 2005 - 2011 (annual percentage change)**



**Source:** ILO, based on data from the IPS and the National Accounts Bulletin of the BCP.

<sup>14</sup> Almada, Carmen Frutos de and Pedro Ferreira (2007). The own-account worker and his incorporation into the social security system in Paraguay. V International Conference on Social Security Research. Warsaw, 5-7 March 2007, "Social security and the labour market: an irreconcilable gap?"

<sup>15</sup> President of the Republic. *Informe de gestión 2011*. Asunción, 2011.

<sup>16</sup> Law No. 3193/07 (longshoremen), Law No. 3.515/08 (employees of the Attorney General's Office), Law No. 4.370/11 (private schoolteachers), Law No. 4.199 /10 (artists).

<sup>17</sup> Information provided by the IPS.



Besides these changes, other legal reforms had a positive effect on expanding retirement coverage. In 2004, Paraguay ratified<sup>18</sup> a reciprocity agreement among MERCOSUR countries, by which a worker who contributed in a MERCOSUR member country can access social security benefits in another member country.

In 2009, the country also adopted reciprocity agreements between the different fiscal funds and the IPS,<sup>19</sup> which establishes that a worker who has contributed to different funds of the system, without fulfilling the necessary period of contributions in any of them to access the respective benefits, has the right, at age 65, to request recognition of the period of contributions to each fund. As a result, the worker can have prorated tempore access to a retirement pension, or his or her rightful claimants can request the death benefits stipulated for beneficiaries.

Finally, the adoption of Law No. 3.404/07, on continuing benefits, gives an insured individual who has retired but does not meet the requirements for obtaining regular retirement benefits the right to request continued IPS coverage so that he or she can receive special retirement benefits. Likewise, the adoption of Law No. 4.290/11, which establishes a reduced retirement, enables those workers who contributed to the IPS for a shorter period than that established, to be awarded proportional compensation. During this period, the number of public employees also increased, who in their majority became contributors to one of the fiscal funds.

In addition to the advances made in the legislative framework, areas of the two institutions responsible for monitoring were strengthened: the Ministry of Justice and Labour and the IPS. The Ministry of Justice and Labour launched the Decent Work Operative<sup>20</sup> in 2008. The Ministry coordinated actions with other sectoral institutions involved in monitoring prioritized economic activities, including public transportation, construction, agriculture and tourism. However, it is not possible to estimate the effect of these activities on the increase in the number of contributors, given that this can be direct in the enterprises involved, and indirect in others due to the "demonstration" effect.

The main actions the IPS has implemented to reduce evasion, in addition to audits and the digitalization of its archives and records, was the crossing of its information with that of public sector entities that work with private enterprises. This is the case of the Tax Secretariat (SET) of the Treasury and of the National Directorate of Public Contracting (DNCP). These measures have not been legally incorporated into any mechanisms for dynamic information management. Thus, they are vulnerable to turnover among officials and public servants, for which reason controls should be carried out regularly.

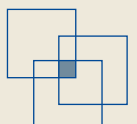
## 4. Conclusions and challenges

The evidence reviewed demonstrates that in recent years, institutional reforms have effectively reduced informality –particularly those measures that enabled increased social security coverage–, although the context of stable, sustained economic growth also contributed to this progress. Despite the above, the social security system faces important challenges for achieving more rapid progress.

18 Reciprocity Agreement of Contracts between Social Funds of MERCOSUR, which was adopted by Law N° 1513 of 13 December 2004.

19 Law No. 3.856/09 of reciprocity between Paraguayan funds.

20 President of the Republic. *Informe de gestión 2009*. Asunción, 2009.



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Key challenges include evasion through non-compliance with current law, the weakness of oversight institutions –the Treasury, Ministry of Justice and Labour and the IPS– and of cross-referenced control systems: Treasury (Tax Secretariat, National Directorate of Public Contracting), the Ministry of Justice and Labour and the IPS. The goal is to reverse non-compliance with the law of the business sector.

In addition to the challenges mentioned, the weak or absent representation of labour actors in labour regulatory or decision-making bodies and the excluding effect resulting from the emphasis on current regulations in social security coverage –retirement– via the dependent employment relationship, exclude a large percentage of the labour force.

In addition, policies for micro, small and medium-sized enterprises should be strengthened to improve their productivity and possibilities for assuming the costs of formalization. Likewise, efforts should be made to address cultural aspects of a large share of the population that remains ignorant of the importance of having social protection (contributory).

In light of the weaknesses mentioned, it is possible to identify some institutional areas that should be strengthened in an effort to reinforce the positive results achieved in expanding social protection coverage in recent years. First, it is necessary to strengthen oversight institutions through the improved management of IPS internal information and the incorporation of inter-institutional mechanisms for crossing-checking information and for systematic, ongoing coordination. Moreover, the current system of incentives should be evaluated to ensure that sanctions contribute to reducing evasion.

With respect to coverage, current modes of access to IPS should be disseminated among those who have the right to protection but have low coverage, especially recently incorporated collectives. Along these same lines, a medium- and long-term plan should be developed and implemented to guarantee increased IPS coverage of labour collectives that currently demand access (newly employed youth, firefighters and nurses, among others). In addition, a mode of IPS access should be designed and implemented for the population living in poverty –mostly own-account or unpaid workers, particularly in the rural sector– which is in keeping with their payment capacity.

To complement the above, procedures for formalizing enterprises should be simplified, costs and times required should be reduced and efforts should be made to raise awareness of citizens (young and adult workers, employers and others) regarding the importance of social security for ensuring quality of life in old age.

While the implementation of these measures seeks to consolidate and expand on the advances made in reducing informal employment in recent years, actions should also be taken in two complementary areas: on the one hand, to prioritize the conditions that enable robust, stable economic growth; and on the other, to advance in closing gaps in production and working conditions in the Paraguayan economy, which operate as structural constraints to achieving more significant and sustainable reductions in informal employment.

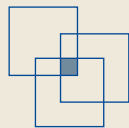




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# FORLAC

PROGRAMME FOR THE PROMOTION OF FORMALIZATION  
IN LATIN AMERICA AND THE CARIBBEAN



NOTES ON FORMALIZATION

Regional Office for Latin America and the Caribbean