Old Age Financial Security of the Informal Sector

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Abstract

While many countries currently have a very structures old age protection program to smooth elderly's consumption at retirement, the programs are tailored made for the formal sector and not for the informal sector. The workers in the informal sector are often left without formal old age protection and have to turn to other means of protection to finance their retirement expenses. We assess the old age financial security in a sample of 400 urban informal sector workers in the capital city of Malaysia, Kuala Lumpur. The aim of this paper is twofold. The first is to analyze the characteristics of informal sector workers and, in particular the availability of old age protection for the workers. The second is to propose policy for old age protection of the informal sector workers. The study finds that the workers of the informal sector do worry and plan for old age. Nevertheless, only a few are currently being protected by formal old age plans and plan to depend on personal savings, family support and insurance in the future. The article concludes in providing some policy implications on how the well being of the informal sector could be improved through a more structured old age protection. Some policy implications to ensure the existence of old age programs for the workers in the informal sector include revising the performance of the EPF through high dividends, increase confidence to the fund, encourage contributions and make contribution via cooperatives.

Keywords: Informal sector, old age protection, financial security

1. Introduction

Given the changing the demographic profile of the world, with more elderly in the future, countries all over the world have started to strengthen, revise and reform their old age protection program. The old age protection program could be defined benefit, defined contribution or non-financial defined contribution (NDC). And many countries have succeeded in strengthening their old age program to ensure adequate benefits are achieved at retirement. But, the strengthening of programs benefit the workers from the formal sector the most. Workers in the informal sector do not benefit from the programs as the programs are not designed for them or they are not eligible to claim benefits from the program. Whatever reasons there are, there have not been many old age programs available for the workers in the informal sector. Although proponents of the NDC believe that the scheme suits well for the workers in the informal sector, it has not been proven or tested as no program under the scheme has actually taken place in reality. The workers in the informal sector remain neglected, left out and susceptible to poverty at old age.

Securing income at old age becomes imperative not only to the workers in the informal sector but also to the workers in the formal sector as well. Let yet, at this time, cost of living is increasing and that people live longer due to health and better living condition. A more worrying attention is diverted to the urban area as the issue of urban poverty is on the rise.

The aim of this paper is twofold. The first is to analyze the characteristics of informal sector workers and, in particular the availability of old age protection for the workers. The second is to propose policy to extend old age protection to the informal sector workers. The focus of the analysis is on the informal sector workers in Kuala Lumpur, Malaysia. The rest of the paper is organized in the following manner: Section 2 begins with an overview of the characteristics of the informal sector, particularly in Malaysia and the availability of old age protection. Section 3 presents the methodology adopted in the study. Section 4 profiles the respondents, including their economic and demographic features. The final section draws some policy implications from the preceding analysis on how the well being of the informal sector could be improved through a more structured old age protection.

2. The Informal Sector and Old Age Protection

Malaysia's economy, being a typical developing country, could be classified into the formal or modern economy and the informal or the traditional economy. Commonly, the distinction between the two is based on different production technologies for the former establishment size or social security coverage for the latter (Yuki, 2007). To further elaborate, Yuki (2007) defines the informal (traditional) economy as characterized by small firm sizes, unskilled jobs, low wages, and the loose enforcement of laws and regulations, and it incorporates sectors such as petty trading, domestic services, repair services and basic manufacturing. A more detail definition of informal sector was formalized at the 15th International Conference on Labor Statistician (ICLS) in January 1993, in which the resolution concerning statistics of employment in the informal sector (International Labor Organization (1993) was adopted.As stated in paragraph 5(1) of the resolution:

> "The informal sector may be broadly characterized as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate at a low level of organization, with little or no division between labor and capital as factors of production and on a small scale. Labor relations – where they exist – are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees."

With the resolution in mind, the criteria for informal sector enterprises have the following characteristics (Hussmans, 2004 as cited in Kamaruddin and Mohamad Ali, 2006, 6):

i. Private unincorporated enterprise, i.e. enterprises owned by individuals or households that are not constituted as separate legal entities independently of their owners, and for which no complete accounts are available that would permit a financial separation of the production activities of the enterprises from the other activities of its owners.
ii. All or at least one goods or services produced are meant for sales or barter transaction;
iii. Their size in terms of employment is below a certain threshold to be determined according to national circumstances, and/ or not registered under specific form of national legislation, and/or their employees are not registered.
iv. Involved with non- agricultural sector, including secondary non-agricultural activities of enterprises in the agricultural sector.

All these formed the conceptual framework of informal employment in Malaysia to consist own-account workers, employers, contributing family workers, employees and members of producers' cooperatives. (Baharudin, et al., 2011). An earlier estimates using mixed income indicated that the informal sector of Malaysia contributed approximately 13.0 percent to the Gross Domestic Product (GDP) in 2005 (Baharudin, et al., 2011). 2006 pilot survey on the informal sector indicated that 14.2 percent of the labor force was involved in some form of informal employment (Ridzuan, R. and Ponggot, S., 2009).

Informal employment is often linked to informal social protection in terms of employee's welfare; let them be health, insurance, job security or even retirement benefits. Although a particular country may have one or more social assistance programs, the programs are only reachable to few percentage of the population, especially those from the formal sector. According to Palacious and Pallares-Mirallets (2000) as cited in Jung and Tran (2012), the coverage od social security systems are usually less than 10 percent in low income countries and rarely exceed 50 percent in the middle income countries. In that manner, the workers in the informal sectors are left out from formal protection and vulnerable to all sorts of risks in regard to income, health and other socio economic indicators that could affect their lifestyle and economic wellbeing.

Being the first country in the world to introduce the provident fund to its workers, Malaysia has been very successful in ensuring employers compliance towards monthly contribution to the fund. The percentage of defaulting employers is less than two percent. In fact, it has reported by the fund's general manager that the rate of defaulting employers for the fourth quarter of 2012 had reduced to 1.2 percent from 1.48 percent (The Star, 2013). The provident fund, known as the Employee Provident Fund (EPF), established in 1951 has two main purposes: retirement and pre retirement. At least 70 percent of the employee-employer's monthly contribution is directed for retirement purposes while the rest 30 percent could be withdrawn for pre retirement purposes to include education and housing financing. Although many feel that the accumulated savings in the EPF are deemed to be inadequate to finance retirement expenses and deplete fast the first instance the money is withdrawn upon retirement, with good management and planning, the accumulated savings could last a long time and guarantee a comfortable living during retirement. Nevertheless, this phenomenon is only enjoyed by the few percentage of the labor force as the EPF is only meant for the formal private workers. Civil servants, similar to the practice of other countries, are protected by government pension scheme. The workers of the informal sectors are left out from the scheme, living them with nothing at old age, unless they are still fit to continue working to earn few dollars for living.

Realizing this, the government has made several efforts to include the workers of the informal sectors to be part of the nation's old age protection program, beginning with voluntary contributions of a minimum RM50 per month to the introduction of the EPF's 1Malaysia retirement savings schemes. The voluntary contributions of a minimum RM50 per month does not appear to be very attractive, hence fail to reach a bigger population of the labor force. Since introduced in January 2010, the EPF's 1Malaysia retirement saving schemes, designed for the self-employed and those without a fixed monthly income has reached more than 54,000 contributors totaling up to RM144.60 million (The Star, 2012). The scheme is still a voluntary scheme (minimum RM50 per month) but contributors will not only benefit from the EPF annual dividend but also the additional contribution of 5 percent (to a maximum amount of RM60 per year) by the government until year 2014. Early estimates on the number of informal sector employment in Malaysia in 2006 were reported to be 708,100 people. Hence, to date, the percentage currently contributing into the EPF's 1Malaysia retirement savings scheme is approximately 7.6 percent. This translates to a big 92.4 percent of the workers in the informal sector not contributing and not protected by the formal scheme. Saidatulakmal, et al. (2010) found that a majority of the elderly in Kuala Lumpur is currently depending on family protection to finance old age expenditure. The study investigated the elderly whom, during their working years, worked at the private sector, protected by the EPF and had run down their EPF retirement savings and thus reverting to the traditional social protection, that is family support. The situation could be even detrimental for the workers of the informal sector workers who have no old age protection to begin with.

3. Methodology

This study was part of a large-scale study conducted in the capital city of Kuala Lumpur covering three main categories of informal sector activities that are service workers, shop and market sales workers, craft and related trade workers and elementary occupations. These groups of occupational groups whose chosen based on the 2006 data reporting that the highest percentage of informal employment was in Craft and Related Trade Workers (41.7%), followed by Service, Shop and Market Sale Workers (20.5%) and Elementary Occupations (15.8%).

The study interviewed 400 respondents covering the three major races in Malaysia (Malay, Chinese and Indians) face-to-face. Structured questionnaire was used for the study. The questionnaire was divided into several parts. Part A takes information on the socio demographic profile of the respondents, Part B seeks information about savings, wealth, income and preparation for old age, Part C is the information on the old age program.

4. Findings

Table 1 shows the socio demographic profile of the respondents. The number of male respondents is almost equal to the number of female respondents (49.3 percent and 50.7 percent respectively). The respondents aged between 20 to 30 years old cover 60.5 percent of total sample, because mostly the young people are involved in informal sector. Some of them have their own business and some of them are doing part time jobs to finance their educational expenses. The respondents aged between 31 to 50 years old are less than 20 percent and the remaining three groups are less than 5 percent. Malay, Chinese and Indian respondents are 49.3, 39.8 and 10.8 respectively according to the population size. Married respondents are 45 percent and 55 percent of respondents are single. Respondents who have attended secondary school are 83.3 percent, while 12.8 percent had higher education and only 3.5 percent had attended primary school. Income is information that is very difficult to gather. A big proportion of our respondents, about 239 of them did not report their average three months income. Out of the 161 who reported their income, the minimum income reported is RM350 and the maximum income reported is RM50,000 with an average income for past three months amounted to RM2,987.89.

Table 1: Socio demographic profile of respondents (in percentage)

Characteristics	**Sample Size = 400**
Gender	
Male	49.3
Female	50.7
Age (Years)	

Less than 20	4.0
20 – 30	60.5
31 – 40	17.8
41 – 50	12.3
51 – 60	4.8
More than 60	0.8
Race	
Malay	49.3
Chinese	39.8
Indian	10.8
Marital Status	
Married	45.0
Single	55.0
Education	
Primary Education and Informal Education	4.0
Secondary Education	83.3
Tertiary Education	12.8
Average Income for three months	
Minimum	RM350.00
Maximum	RM50,000 .00
Mean	RM2,987.89

A big majority of the respondents are currently not enrolled in any old age protection scheme (Table 2). Only a small 28.2 percent are enrolled in an old age protection scheme, mainly the EPF. Those without any formal financial protection schemes plan to protect themselves with other forms of financial protection that include personal savings. Given the increase in the cost of living, intense urbanization and rise of nuclear family concept, less than a quarter of the respondents plan to depend on their family (children) for old age. The survey also indicates that insurance has gained popularity as mean of financial protection for old age. More than fifty percent of the respondents own a property, mainly houses. Property could be regarded as an investment important for the future. At the same time, a big percentage of the population (76.5%) do save for old age regardless whether they are currently protected in old age program or not. The study, however, does not inquire on the amount of savings and where the money is saved. Therefore it could not be concluded on whether the savings is adequate to fully or partially financed old age expenditure. Sadly, the mean value on the adequacy of benefits provided by the EPF is only 2.84 (out of 5), which is slightly above the average value of 2.5. This could be an indication that even if they contribute to the EPF, the benefits provided by the provident fund could still be inadequate to fully finance old age expenditure.

Table 2: Information on old age protection

Current Enrolment in Any Old Age Program	
Yes	28.2
No	71.5
Other forms of protection*	
Personal savings	56.75
Insurance	24.5
Family support	24.75
Loans	0.5
Others	1.5
Own a property	
Yes	52.8
No	47.3
Adequacy of Benefits from the EPF	
Mean value (out of 5)	2.84
Savings for Old Age	

Yes	76.5
No	23.5

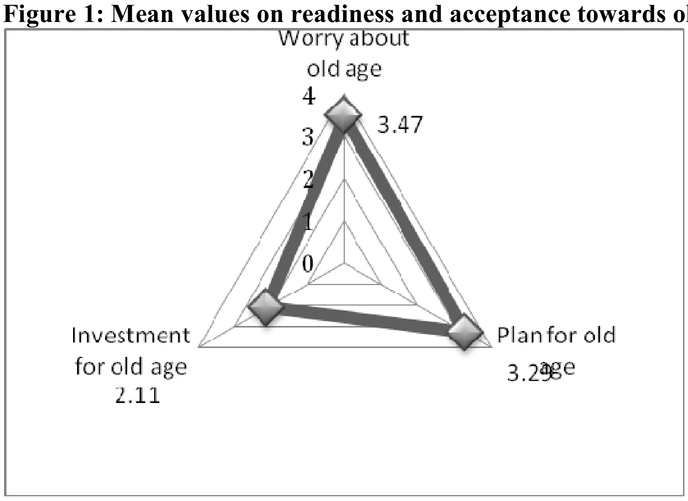
Note: *value is more than 100 percent as some respondents plan to protect themselves with more than one protection.

Respondents were also asked to rate their actions on the followings on a scale between 1 to 5 with 1 for never and 5 for always.

1. Do you worry about old age?
2. Do you plan for old age?
3. Do you have investment for old age?

These questions were posed to understand the readiness and acceptance of the workers towards old age because this would definitely affect their decisions on old age protection. As shown in Figure 1, the mean value (out of 5) of worrying about old age and plan for old age is 3.47 and 3.29 respectively. The reported mean value is above average, a good indicator that many workers in the informal sector are concerned about old age and do make some plans for old age. Nevertheless, the mean value on investment for old age is 2.11, which is below average. Although the workers of the informal sector worry about old age and plan for old age, the planning often does not include investment in monetary form. This finding is not surprising given the fact that their income is relatively small to be set aside for investment purposes. The planning for old age would most probably be in other form in addition to monetary.

Figure 1: Mean values on readiness and acceptance towards old age



5. Conclusion and Policy Implications

This paper has investigated the profile and characteristics of the workers of the informal sector and their old age protection. Similar to what had been discussed in many literatures, As expected a majority of the workers in the informal sector are not covered by a formal old age protection program. The low income commonly associated with the sector also makes it difficult for them to contribute consistently on a monthly basis into a provident fund. Although the study finds that the workers of the informal sector are worried of old age and do plan for it, the study also concludes that the plan for old age mostly does not involve monetary values.

Jenkins (1993) as cited in Ginneken (1999) mentioned that most developing countries social security administration are unable to deal with the special circumstances of the self-employed and casual wageworkers. Mainly, this is due to the fact that their contributions are difficult to collect, and maintaining up-to-date and correct records is administratively complicated as these groups of people often work intermittently and irregularly with no fixed income. To add, the casual wageworkers also work with many different employers. As a result, it is very difficult to determine a level of replacement rate of income. Usually, the approaches adopted by governments to integrate self-employed workers into the formal pension insurance programs have met with very mixed success (Bailey and Ginneken 1998).

While the Malaysian government has only succeeded in persuading a small 7 percent of the workers in the informal sector to save in the EPF, the study concludes that, in general, a big percentage of the workers of the informal sector do save for old age, whether or not they are currently being protected by any formal old age program or not. One of the reason that could be highlighted on the reluctance of the workers in the informal sector to invest in the EPF is the fact that the study finds that the workers of the informal sector believe that the benefits form the EPF is inadequate to finance retirement expenses. In other words, investing in other funds, including savings in banks or financial institutions could provide a higher return. Let yet, now with banks being guaranteed by insurance to guarantee the depositors money. For the Muslims, they would prefer to save in Tabung Haji (TH), a pilgrimage account. This findings provide a very simple solution for the government, that is to ensure that the EPF is able to provide a higher return and that the confidence of the contributors to the EPF could be enhanced. They have also been urges from the Malaysia Trade Union Congress in 2012 for the EPF to increase the dividend declared to the savings. In fact, the EPF is known to be one of the largest investor in Malaysia and has been reported to soar an investment income of RM7.02 billion in the third quarter of 2012, ending September 30 (The Star, 2012). Since after the 1997 financial crisis, the dividend declared by the EPF has shown a downward trend since the highest reported dividend rate reported in the late 1980s of 8.5 percent. Since then, the highest dividend ever declared was 6 percent in 2011. In response to this, the EPF has made an announcement that the EPF may declare higher dividend for 2012. The announcement is to be made on the third week of February. Although many were anticipating the increase given the general election nearby the corner, there is worry that providing a dividend higher than 6% could be detrimental in low interest are scenario now (The Star, 2012). But whatever it is, something needs to be done to get the confidence of the workers to be able to contribute to the EPF. Although personal savings may seem to be one of the best options, savings in EPF could provide a more guaranteed income during retirement as the money could only be withdrawn at retirement age and that the money will continue earning dividends year after year.

The government has shown a great effort with the introduction of the EPF's 1Malaysia plan to the workers of the informal sector. The joint contribution by the government contribution of 5 percent (to a maximum amount of RM60 per year) sounds attractive but this would not attract the workers to contribute. What more when the contribution from the government is only until the year 2014. A simple calibration analysis done by Saidatulakmal and Muhammad Waqas (2011) found that the amount of accumulated savings in the EPF is more for the one receiving additional contribution from the government compared to the accumulated savings that have no additional accumulation. The calibration analysis also indicate even with initial contribution rate of RM50, increase by 20 percent every five years, contribution matched by the government throughout the entire contribution period and starting contributing at the age of 21, the accumulated savings to be withdrawn monthly upon retirement barely put the contributor above the current poverty line income. Limiting government's contribution until the year 2014 and only to a maximum of RM60 per year is inadequate and insufficient to influence the workers of the informal sector to contribute into the fund. A more convincing role from the government needs to be adopted to show that the government does care for the workers of the informal sector. Perhaps a higher initial contribution from the government is needed to encourage workers to just start contributing. Government's burden in financing the contribution could be released on stages and being reduced slowly as years pass by. Government's contribution could be stopped at least after the accumulated savings have reached a desirable age for a minimum income upon retirement. The numbers of years of government contribution differ from one person to another. A more stringent rule could be applied to the workers. For example, government's contribution goes hand in hand with the contribution made from the workers of the informal sector. If a worker defaults in its contribution, government's contribution to the fund could also stop. However, there must be an exception guideline for this given the inconsistent income received by the workers in this sector.

Another option would be to encourage the workers to save through their cooperatives. At present, there are many cooperatives for workers in the informal sector but the role of the cooperatives is limited to loaning money, resolve disputes among members and organize members' related activities. The scope and role of the cooperatives could be expanded to include managing members' savings for retirement. The cooperatives could be put under the Ministry of Entrepreneur and Cooperative Development to monitor the activities and take charge in investing and safe guarding the members' savings. Proper guidelines explaining vividly the role of the ministry and the function of the cooperatives need to be formed prior to engaging both parties to the said responsibility. Cooperatives could be a better choice for the workers in the informal sector as it is more common for the workers of the informal sector to trust their cooperatives compared to savings their money elsewhere, including the EPF.

Acknowledgement

This study was funded by the Fundamental Research Grant Scheme, Ministry of Higher Education, Malaysia. The author wishes to thank her graduate student, Mr. Muhammad Waqas Ameer for his assistance with data collection, data entry and preliminary data analysis.

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