

► Social Protection Spotlight

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Extending social security to workers in micro and small enterprises

Lessons from international experience

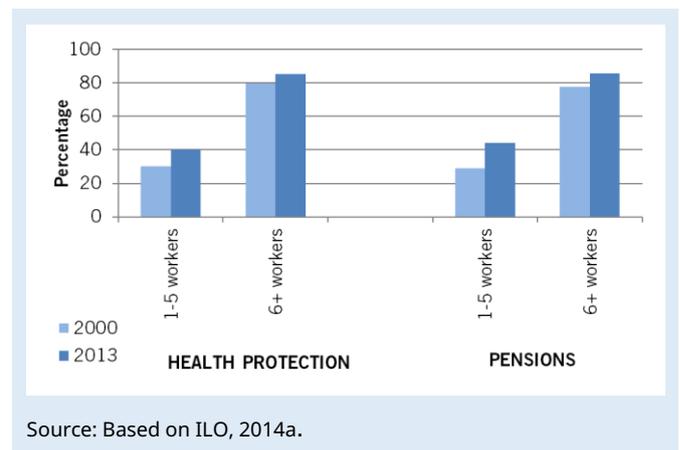
Closing social protection gaps for workers in micro and small enterprises

The large majority of employees worldwide work in micro and small enterprises (MSEs).¹ MSEs and own-account workers account for 70 per cent of total employment, reaching up to 90 per cent of total employment in some countries (ILO 2019d). For example, in Indonesia, they represent 99 per cent of all enterprises, absorbing 97 per cent of the total workforce (Torm 2019).

However, for various reasons, workers in MSEs tend to be less likely to be covered by social security than workers in larger enterprises. As a result, many of them find themselves among the 71 per cent of the global

population with no or insufficient social protection coverage (ILO 2018b; 2017b). For example, in Latin America, the level of social security coverage in microenterprises with 1–5 workers is about half of the level in large enterprises with 6 or more workers, although for both categories, coverage substantially increased between 2000 and 2013 (see figure 1).

► **Figure 1 : Health and pension coverage of salaried workers by enterprise size, Latin America, 2000-2013**



MSEs often operate at a low level of productivity and according to a short-term horizon and face difficulties in complying with minimum wage and social security legislation due to their limited administrative and financial capacities. It is estimated that eight out of ten enterprises are informal, particularly MSEs (ILO 2018b). This means

¹ There is no single definition of MSEs and they are usually based on the number of employees, annual turnover or the value of enterprises. Some definitions include self-employed workers in the category of microenterprises, others do not. In this brief, we use the following definitions, based on ILO 2019e: Micro-enterprises are defined as enterprises with 2 to 9 employees, small enterprises as those that have 10 to 49 employees (ILO 2019d, 1). Self-employed workers are addressed in a separate issue brief (ILO 2021b).

they are not covered or insufficiently covered by laws or other formal arrangements; for example, their business may not be duly registered. The lack of formalization of small economic units also entails a lack of social protection coverage for their workers (ILO 2017a).

But even where MSEs are formally registered, their workers are not necessarily guaranteed labour and social protection. This may be due to gaps in social security legislation or non-compliance with the applicable legislation, which is in many cases also linked to the limited administrative and financial capacities of MSEs.

The lack of social security constitutes a significant source of vulnerability for workers in MSEs and their families, as the lack of access to health care and income security keeps many of these workers in a vicious cycle of vulnerability, poverty and social exclusion. At the same time, the lack of social security coverage also constitutes a business risk for MSEs that can hamper their transition to higher levels of productivity. For example, evidence for Indonesia and Viet Nam demonstrates that enterprises that are compliant with social security regulations are more profitable than other enterprises (Lee and Torm 2017; Torm 2019). Therefore, enhancing social security coverage for workers in MSEs makes positively contributes not only to their individual welfare and enjoyment of human rights (in particular the rights to health, social security and an adequate standard of living) but also to the sustainability of enterprises and their countries' economic and social development (ILO 2017b; OECD and ILO 2019; RNSF 2017).

The COVID-19 crisis and its socio-economic impacts have revealed once again the vulnerabilities faced by MSEs and their workers. The lockdown measures introduced by many governments in response to the COVID-19 crisis have resulted in reduced activity or closure of many businesses. The limited capacity of MSEs to weather the economic crisis and the lockdown measures has affected workers in MSEs in particular.

Many workers in MSEs and their families did not have adequate social protection coverage increasing their risk to fall (back) in poverty. The lack of health protection and sickness benefits compels many workers in MSEs to work even when they are sick, thereby not only jeopardizing their health but also potentially undermining public health efforts to curb the virus (ILO 2020d). In addition, the lack of unemployment protection and other income support leaves them in a very vulnerable position (ILO 2020b; 2020c).

To avoid the closure of MSEs and employment losses and to protect the workers employed in these enterprises, numerous governments have introduced emergency measures through the extension of existing or new social protection schemes. Measures included ensuring at least a basic level of income security and access to health care for small and micro business owners and the workers they employ, and keeping businesses afloat and retaining jobs, for instance through partial employment retention benefits (ILO 2020b; 2020a; 2021c). Moving beyond temporary measures, it is key to extend social protection to workers in all forms of employment and to facilitate the transition of enterprises and workers to the formal economy. This contributes increasing their resilience to future crises and to ensure universal social protection (ILO 2020a; 2020e).²

The 2030 Agenda for Sustainable Development underlines the role of social protection in reducing poverty and inequality and promoting human development (ILO 2017b). Considering the relevance of MSEs as job creators in many economies, it is paramount to extend coverage to workers in such enterprises, taking into account the diversity of the sector (ILO 2019d; 2015).

Based on a more comprehensive publication (ILO 2021a), this policy brief stresses specific challenges for the extension of social security to workers in MSEs and explores some policy options for enhancing their social security coverage, based on international experience and guided by ILO social security standards.

Challenges in extending social security to workers in micro and small enterprises

Before turning to possible solutions and country experiences, potential barriers to the coverage of workers in MSEs will be discussed in more detail.

Legal exclusion

In some countries, social security legislation may specify that enterprises below a certain minimum size may be exempted from obligations with regard to social security coverage, which leaves workers in these MSEs unprotected by statutory social insurance (Mesa-Lago 2008; ILO 2013). Some countries have gradually extended social insurance coverage, starting with workers in larger enterprises, and have not yet included smaller

² More information and relevant tools on the social protection response to the COVID-19 pandemic, are available here: <https://www.social-protection.org/gimi/ShowWiki.action?id=62>.

enterprises. The rationale behind this approach is driven by concerns about administrative capacities since the inclusion of workers in MSEs requires sufficient administrative capacity for both enterprises and social security institutions. A progressive approach can help to build such capacity. For example, Viet Nam extended coverage to workers in enterprises with less than 10 employees in 2005.

In addition, many workers in MSEs find themselves in employment relationships that are not clearly identifiable, are ambiguous or are hidden, and for which it is therefore more difficult to identify whether or not workers are eligible employees for social insurance schemes (ILO 2013).

Administrative barriers

Even if workers are legally covered, in some countries compliance with the social security law is weaker among MSEs than among larger enterprises because many MSEs struggle to comply with administrative requirements owing to their more limited administrative capacity. For example, many MSEs do not have specialized staff to deal with social security matters. Furthermore, business owners with low levels of education may lack the skills to comply with administrative requirements, in particular if administrative procedures are overly complex and burdensome.

As a result, complex and burdensome administrative procedures and services can hamper enterprise formalization and discourage employers to enroll their employees in the social security system. This is particularly relevant for MSEs in rural and remote areas that face geographical barriers to access social security offices. Their time spent on administrative procedures has a direct opportunity cost in terms of lost revenue. As a result, many MSEs fail to declare their workers, thereby excluding them from social security.

Limited financial capacities

Many MSEs are characterized by low productivity and in many cases both business revenues and wages are lower and often more volatile than in larger enterprises. This has consequences for employers' and workers' financial capacity to contribute to social insurance.

Lack of enforcement and compliance

Weak enforcement of the law may hamper social security coverage for workers in MSEs. Inspectorates often face difficulties in systematically reaching MSEs, owing to a limited number of staff and sometimes also a lack of adapted tools and methods. For this reason, they tend to

focus more on larger enterprises as inspections in MSEs are often more time-consuming and relatively more costly compared to larger enterprises, where more workers can be covered per enterprise visit.

Weak enforcement mechanisms can contribute to a low level of compliance. In addition, a lack of trust in public institutions as well as limited regulatory knowledge can be important factors that discourage employers and workers from participating in social protection schemes.

Furthermore, MSEs may not have the necessary information and knowledge to register their workers with social security or may be reluctant to do so. This may be compounded by a lack of organization and access to information among MSEs. As informal MSEs are beyond the reach of the formal legal and regulatory framework, this poses additional challenges to extend social security to workers.

Lack of unionization

The relatively low degree of unionization and lack of information among workers in MSEs can constitute effective barriers to the extension of coverage to workers in MSEs. In some countries, unionization and collective bargaining are only possible for enterprises above a certain size (ILO 2013).

Lack of coordination and integration with other policy areas

Many of the challenges related to informality often go beyond the scope of what can be addressed by social protection policies or institutions. A lack of coordination between social protection policies and other relevant policy areas, such as enterprise formalization policies, labour market and employment policies, enterprise development policies and macroeconomic policies can constitute a major barrier to the extension of coverage (Nguyen and Cunha 2019). For example, many MSEs that do not register their employees operate in the informal economy because of complex and costly procedures to obtain business licences and high entry and operational business costs (e.g. high registration fees or high taxes).

Strategies to extend social security coverage to workers in micro and smaller enterprises

Many countries have taken steps to remove the barriers discussed above and extend both legal and effective

coverage to workers in MSEs, in line with the guidance provided by ILO standards.³

Extending legal coverage to smaller enterprises

Legal coverage can be extended to workers in MSEs through different means, such as lowering or removing minimum thresholds with regard to the enterprise size in the social security or labour legislation or including additional categories of workers in the legislation to take account of the diversity of employment situations.

For example, the Government of the Republic of Korea gradually extended health and pension coverage to workers, starting in the case of compulsory health insurance scheme in 1977 for those working in companies with more than 500 employees and then gradually lowered the threshold to 300 employees in 1979, 100 employees in 1981, 16 employees in 1983 and 5 employees in 1988. Similarly, mandatory pension coverage was introduced for companies with more than 10 employees in 1988 and lowered the threshold to 5 employees in 1992 (Kwon 2009).

The Government of Jordan extended coverage to those that were previously excluded from social insurance, as well as to Jordanians working abroad through the Temporary Law on Social Security in 2010. One of the objectives was to lower the threshold to include workers in enterprises with less than five employees in the social insurance scheme which has been achieved by gradually extending to enterprises on a geographical basis from zone to zone (ISSA 2009; NSour 2011).

In Cambodia, the minimum threshold was reduced in 2017 from enterprises with 8 or more employees to those with 1 or more employees, thereby significantly expanding legal coverage through the National Social Security Fund (Both et al. 2018).

Viet Nam has also used a gradual approach to extend coverage. Mandatory coverage was initially limited to enterprises with 5 or more employees, before it was extended to all enterprises for employees with a contract of three months or longer in 2005. In 2014, coverage was extended to employees with a contract of one month or longer (Nguyen and Cunha 2019).

In addition, in view of the diversity of employment relationships in MSEs, initiatives that aim to broaden the scope of workers covered by law, such as including those on part-time contracts, temporary workers or workers without a formal contract, are particularly relevant. For example, in Malawi, the Employment Act 2000 defines an employee as a “person who offers his services under an oral or written contract of employment, whether express or implied” and as “any person, including a tenant share cropper, who performs work or services for another person for remuneration or reward on such terms and conditions that he is in relation to that person in a position of economic dependence on, and under an obligation to perform duties for that person more closely resembling the relationship of employee than that of an independent contractor”. In India, the Unorganized Workers’ Social Security Act 2008 defines different categories of workers in the “unorganized” sector, including wage workers,⁴ home-based workers and self-employed workers.

While the extension of legal coverage is obviously a critical step in extending coverage to workers in MSEs, in many cases this is not sufficient to ensure effective coverage for this group. Additional measures are needed to reduce the administrative and financial burden of MSEs and ensure effective protection.

Facilitating access and simplifying administrative procedures

Removing administrative barriers is one of the key elements to enhance coverage of workers and employers in MSEs and facilitate their transition to the formal economy. Simplifying and facilitating access to registration and other administrative procedures can help to encourage MSEs to register their workers in social security schemes. Concrete measures include providing additional access points as well as mobile and online access. When workers and enterprises have access to the internet and are well informed, online registration can help to reduce distance barriers and red tape. For example, in Brazil’s *Individual Microempreendedor (IME)*

³ Relevant ILO standards include in particular the Social Protection Floors Recommendation, 2012 (No. 202) and the Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204).

⁴ Wage workers are defined as persons employed for remuneration in the unorganized sector, directly by an employer or through any contractor, independent of place of work, whether exclusively for one or more employers, whether in cash or in kind, whether as a home-based worker, or as a temporary or a casual worker, or as a migrant worker, or workers employed by households including domestic workers...” (art. 2(n)).

► Social Protection Spotlight

Extending social security to workers in micro and small enterprises

regime, registration for individual micro-entrepreneurs⁵ is free of charge and can be undertaken through a simplified online registration portal that includes the trade register, tax office and social security office (see box 1). There is no need to present any documents (although several registration numbers must be entered in the platform) and entrepreneurs can count on the support of an accounting firm free of charge for a first consultation.⁶

► Box 1 : Facilitating coverage for micro and small enterprises in Brazil

In 1996, the Simples Nacional Law 9317 simplified tax regulations for MSEs by creating a unified system for the payment of tax and social security contributions. This mechanism allows eligible companies to file a single simplified annual tax declaration instead of monthly tax declarations for eight different taxes. Micro and small businesses with a gross annual income of less than R\$ 4.8 million are eligible. Micro-entrepreneurs with a maximum of one employee can use the Microempendedor Individual mechanism, which allows for one flat payment integrating seven different taxes and social security contributions. However, in order to avoid abuse, some sectors are excluded from eligibility, such as entrepreneurs that engage in intellectual activities (accountants, doctors, lawyers, etc.).

Between 2009 and 2018, the number of registered MSEs increased from about 3 million to 5 million. The monotax regime also facilitated the formalization of workers; the entities registered under this regime reported that they employed 10.6 million workers in 2017, equivalent to one quarter of all employees in Brazil. The main motivation for participating in this regime is to gain access to social security.

Source: Based on ILO, 2019e.

Some countries, such as Fiji, Côte d'Ivoire and Thailand, use electronic services to facilitate social security registration and other administrative procedures, thereby reducing the time and costs of MSEs for office visits (ISSA 2018b; 2017) (see box 2).

► Box 2 : Employer Online Portal in Fiji

Prior to 2016, monthly contribution schedules had to be submitted and posted to member accounts physically. The National Provident Fund in Fiji created an Employer Online Portal through which employers can easily submit their social security declarations online and which automatically updates member accounts on payment in real time. This has resulted in a simplification of procedures for employers and an increase in contribution compliance. As of 2018, more than 6,000 employers (92 per cent) used the portal instead of submitting their declarations manually, accounting for 98 per cent of all contributions paid

Source: Based on (ISSA 2018a)b.

Integrated service delivery mechanisms, such as one-stop-shops, can help to improve access to social protection, particularly in rural areas. They provide an integrated point of service through which workers and employers can access several social protection programmes and other services, such as employment or business services. By reducing time and costs spent for administrative procedures, such integrated services can promote social security and business registration and facilitate transitions to the formal economy. Combining simplified administrative procedures with other measures to strengthen incentives and ensure the enforcement of simplified rules has been effective in many cases, yet the impact of removing administrative procedures can differ according to the context. An example can be found in the Philippines (see box 3).

► Box 3 : One-stop-shop in the Philippines

The Philippines Business Registry is an online one-stop-shop aimed at simplifying the business registration process and facilitating enterprise registration. It integrates multiple agencies involved in the business registration process, such as the Department of Trade and Industry, Bureau of Internal Revenue, Social Security System, Home Development Mutual Fund, Philippine Health Insurance Corporation and Local Government Units

Source: Based on Bhattarai, 2018.

⁵ The Individual Micro Entrepreneur statute is open to own-account workers and enterprises with not more than one employee. Additional eligibility criteria on turnover threshold and sector of operation apply.

⁶ Simples Nacional Supplementary Law 123, arts 4 and 18.

Facilitating contribution collection and financing mechanisms

Some countries have developed mechanisms to facilitate the payment of contributions for MSEs and enhance coverage of their workers (Gaarder et al., 2021). For example, Chile's PREVIRED is an online platform that aims at simplifying the declaration and payment of social insurance contributions for MSEs and own-account workers (see box 4).

Some countries, such as Argentina, Brazil and Uruguay, have used monotax (monotributo) mechanisms to facilitate the payment of social security contributions and taxes, thereby reducing the administrative burden of MSEs. Monotax mechanisms offer the possibility for some categories of MSEs to make one flat payment instead of various tax and social security contributions, which greatly facilitates contribution collection. For example, in Argentina, monotributo contributors can make one payment instead of four payments to different systems (ILO 2014a). They also reduce the need to keep accounting records and facilitate the declaration of incomes and effecting payments to different social security and tax systems. In Brazil, for example, microenterprises can file one single simplified annual tax declaration instead of various tax and social security declarations at the municipal, state and federal levels (ILO, 2014d, 2019e; see also box 1).

While participation in monotax mechanisms is usually voluntary, this mechanism is attractive because of simpler procedures and, in some cases, also lower contribution rates. Government subsidies for some categories of microenterprises may be justified under the assumption that, as enterprises grow, they will be able to pay the regular level of tax and social security contributions. Depending on the country, monotax mechanisms can provide a range of benefits; some countries also allow for some flexibility regarding contributions to priority social security branches to encourage enrolment and address low incomes. In Uruguay's monotax scheme, for example, affiliation to the pension scheme is mandatory, while affiliation in the health insurance regime is voluntary for certain categories of workers (ILO 2014f).

Inspection mechanisms and incentives

Some countries have implemented mechanisms to facilitate the inspections of MSEs and enhance compliance and facilitate the transition of informal economic units to the formal economy (ILO 2018a). In some cases, they have removed barriers to the inspection of small enterprises based on their number of employees or turnover, while adopting additional measures to enable inspectorates to

conduct inspections of MSEs (ILO 2018a). For example, Peru has specifically initiated annual inspections of microenterprises by law. The Small and Medium Enterprises Promotion and Formalization Act, 2003 (law 2,815) provides for annual inspections of 20 per cent of registered microenterprises (Daza 2005).

► **Box 4 : Simplifying registration and payment procedures in Chile through the PREVIRED platform**

Chile's PREVIRED portal was launched in 2001 with the aim of offering an entry point for enterprises, employers operating in their own homes and own-account workers, to all procedures of all social security institutions in the country through a single interactive portal. Members can register and pay contributions for pensions, health, employment injury, family allowances and unemployment insurance. The platform is connected to all financial banking institutions and some non-banking institutions, such as credit card companies to facilitate online payments. PREVIRED provides a flexible online 24-hour service that is free of charge, thereby reducing the complexity of payment procedures and substantially reducing the transaction costs for users.

Moreover, users also find other useful information on the portal, such as model contracts or certified software to facilitate accounting (free for enterprises below a certain size).

Source: Based on ILO, 2014b, 2019d; and PREVIRED website, <https://www.previred.com/web/previred/>

A coherent policy framework system which applies adequate sanctions and sets the right incentives is essential for effectively promoting compliance. To achieve sustainable change, it is important to combine sanctions with information and awareness-raising, especially for MSEs (see box 5). For example, Chile has introduced a graduated system of sanctions by setting the level of fines based on the size of the enterprise and the number of workers affected to avoid adverse effects for the most vulnerable. This sanctions framework also allows for the possibility that small enterprises can discharge themselves from the payment of penalties by regularizing workers and attending training sessions. Given that senior staff time usually is a scarce resource in MSEs, participation in such training session has a penalty element (foregone revenue), as well as an awareness-raising element (ILO 2013).

► **Box 5 : Adapting awareness-raising activities to specific groups of workers and employers in Zambia**

In Zambia, the lack of knowledge and awareness on social security were identified as major obstacles to the extension of social protection coverage to MSEs in the construction sector. The Zambia Green Jobs Programme supported the development of communication material and guidelines that were adapted to the construction sector. To promote compliance in the sector, the National Pension Scheme Authority (NAPSA) and the Workers Compensation Fund Control Board (WCFCB), in collaboration with workers' and employers' associations, disseminated communication materials to sensitize and raise awareness among employers and workers in MSEs in the construction sector. The social security awareness materials reached over 1,500 workers, resulting in increased knowledge and appreciation of the importance of registering with social security schemes.

See ILO; YouTube video entitled „Give your workers a NAPSA pension today”.

Source: Based on Zambia, 2016.

In some countries, existing enterprises can under some circumstances declare workers without getting fines for non-compliance during previous years. For example, in Zambia, social security institutions introduced a cut-off registration date. MSEs who have not registered their employees were exempted from paying penalties for the periods they did not register if they registered before this cut-off date (Zambia 2016). In Algeria, between 2008 and 2011 a mechanism was in place to progressively integrate certain categories of MSEs into the mandatory social security scheme for non-salaried workers (Caisse nationale de sécurité sociale des non-salariés).

In addition, compliance with social security obligations may also be linked to access to business services. For example, in Costa Rica, the Business Information System of the Ministry of Economy, Industry and Trade (Sistema de Información Empresarial Costarricense) does not issue micro and small enterprise certificates to companies that are behind on their tax or social security payments (ILO 2014e). These certificates are necessary, among other things, for exempting MSEs from paying some types of taxes, namely the tax for legal persons (impuesto a las personas jurídicas), and for benefitting from enterprise promotion programmes.

Strengthening incentives for formalization through linkages with other policy areas

Linking social protection with other policy areas can contribute to strengthening incentives for the extension of social protection coverage and the formalization of enterprises. It is important to formulate and adopt integrated extension strategies that form part of broader strategies to facilitate the transition to the formal economy.

In this respect, enterprise formalization policies are key to promote the transition of MSEs to the formal economy. Measures can include policies to simplify business registration procedures and reduce transaction costs for MSEs, as well as to facilitate market access for MSEs and measures to enhance their financial inclusion. Furthermore, enterprise policies that promote sustainable enterprises, and in particular the conditions for a conducive environment, are important to enhance business productivity and promote enterprise development, thereby enabling the transition to formality. Measures can include providing support and targeted business development services for micro, small and medium-sized enterprises and enhancing financial inclusion through improved access to finance access to loans for small enterprises (ILO, 2017b).

In addition, adequate tax regulations, well-designed public procurement policies and policies to enhance market access, financing and economic inclusion can also help to strengthen incentives to formalize. A number of countries have taken steps in that direction. For example, the monotax mechanisms not only provide simplified tax regulations for MSEs but also provide them with access to credit and business support initiatives. In Singapore, for example, registered MSEs have better access to banking facilities and are exempted from paying various taxes (Nguyen and Cunha 2019). In Chile, a simplified tax regime was created for SMEs to help them overcome barriers to their payment of taxes and facilitate their transition to the formal economy. The regime includes simplified tax accounting through integrated information technology, as well lower tax rates for MSEs. Between 2013 and 2017, the number of taxpayers under this regime has increased from about 84,000 to 310,680 (ILO 2019c). In Peru, the introduction of e-invoicing technologies allowed to reduce administrative and compliance cost for MSEs and enhanced tax compliance (Bellon et al. 2019).

Furthermore, promoting freedom of association and the organization of MSEs and their workers is essential to push for solutions to their specific challenges. In Kenya, for example, the Bakery, Confectionery, Manufacturing

and Allied Workers' Union has been an important player in campaigning for better workers' rights in MSEs. It has lobbied for a reform of the labour code and its enforcement in the informal economy. The union was also greatly involved in awareness-raising activities for MSE's workers (ILO 2013).

These examples demonstrate the potential of integrated policy approaches that remove barriers to enterprise formalization and social security coverage of workers in MSEs.

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Extending social security to workers in micro and small enterprises

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