



THE KEY TO A SUCCESSFUL EMPLOYMENT INJURY INSURANCE SYSTEM

ITCILO E-CAMPUS / ONLINE KNOWLEDGE

Module 12

Compliance and Evasion Related Issues



International Labour Organization



International Training Centre

Overview

This module presents compliance and evasion related issues that all employment injury insurance scheme face. Vital elements of these schemes, the causes of evasion and their impact are explained in this module. The module also presents examples of measures to enforce compliance in the scheme and case study related to compliance.

Learning Outcomes

By the end of Module 12, participants will:

- Review the critical elements that are related to a contributory employment injury insurance scheme
- Acquire introductory knowledge of types and causes of evasion in an employment injury insurance scheme
- Review methods that ensure an efficient compliance in a scheme
- Acquire basic understanding of a moral hazard in workers' compensation and measures to mitigate it

Legend

If you find this icon , you are facing an **EXTERNAL** link

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What is of vital importance to social security contributory scheme?

- Despite the good definition of a social security scheme, it is difficult to assess its effective coverage as few statistics are available;
- Compliance is important as a contributory social security scheme: the objectives of the scheme will not be achieved if the compliance of the statutory contributory provisions fails;
- Nature and extent of contribution evasion as well as the measures promoting compliance depend on:
 - National circumstances;
 - National initiatives;
 - Resources available for their implementation.

What is of vital importance to social security contributory scheme?

- Non-compliance problem threatens the scheme's legitimacy, its objective of adequate social protection and its financial viability;
- Contribution evasion in EISS scheme has implications for individuals and for the State as well as other social security schemes, which may have to supplement inadequate protection (spillover effect);
- High levels of evasion and avoidance can indicate low public credibility of a social security scheme and reflect on the quality of governance of the scheme and the efficiency of scheme administration;
- Evasion:
 - Creates inequities between employers who meet their contribution obligations and those who do not;
 - Can result in lower *real* replacement rates and/or a higher contribution rate than would otherwise be required.

What is of vital importance to social security contributory scheme?

- Contributions are the main financial sources of an EISS scheme:
 - Their collection and its enforcement of compliance are of vital importance and constitute a major function of the administrative organization.
- The statutory contributory provisions are usually defined in the law establishing the social security scheme which is normally published in the official gazette and other government media;
- The organization in charge of the scheme's implementation and administration has the responsibility and obligation to inform and educate all parties concerned about their rights and obligations;
 - e.g. employers must register their workers and make contribution payment on their behalf.

What are principal types and causes of evasion?

- Knowing the nature of contribution evasion and the reasons behind it helps finding possible practical measures to promote compliance;
- Employers can evade contributions:
 - Reporting insurable employees;
 - Designating them as belonging to uninsurable categories (e.g. casual, part-time or temporary workers or contractors);
 - Reporting the earnings subject to contribution; and
 - Delaying or failing to remit contributions to the social security scheme.
- Scheme's provisions facilitating evasion are:
 - Voluntary coverage of self-employed workers;
 - Non mandatory coverage for small size employers; and
 - Exclusion of certain income elements from workers' wage subject to contribution.

What are principal types and causes of evasion?

- Employers may evade paying social security contributions to reduce their labour costs;
- Factors that contribute to employers' inclination to evasion include:
 - Complex administrative procedures for contribution assessment and collection;
 - Employer's poor record keeping making inspection more difficult;
 - Low risk of being caught or low level of consequent financial penalty and damage;
 - Ignorance of the law, especially by small employers and those in the informal sector;
 - Employers and workers lacking confidence in the scheme;
 - Workers facing high unemployment or job insecurity;
 - Employers facing financial difficulties.

What are measures to enforce compliance (combating evasion)?

- Social security organizations and governments cannot only rely on education and persuasion to encourage compliance, but also on effective enforcement;
- Social security organizations can combat evasion, but they must have the *statutory authority* required for effective enforcement of contribution conditions. They need:
 - **Right to inspect** employer records and unfettered access to ancillary information such as an employer's bank statements, income tax returns, etc. from which estimates of the number of employees and the wage bill can be made and compared to social security registrations and contributions paid. Confidentiality should not be invoked in order to conceal or abet evasion of social security contribution obligations; and
 - **Right to assess and collect contributions due and unpaid and assess enforceable penalties** with social security debts having priority over other creditors, the possibility of attachment of employers' assets, etc.

What are measures to enforce compliance (combating evasion)?

- Social security organizations and governments can take a number of steps to enforce compliance, such as:
 - **Streamline administrative procedures.**
 - Contribution regulations can be simplified;
 - Contribution conditions required by different social security schemes can be harmonized and consolidated;
 - Collecting EISS scheme contributions along with contributions for other social security benefits can improve administrative efficiency, reduce employers' reporting burdens, and increase workers' awareness and interest in their social security programs.
 - **Strengthen enforcement through focused and timely inspections.**
 - Effective enforcement requires timely verification of employer returns and prompt investigation of possible discrepancies;
 - Inspectors must be in sufficient number, well-trained, well-equipped and adequately remunerated;
 - Enforcement activities are expensive, but they are a legitimate and necessary expense of a social security scheme;
 - Rotation of employers to be inspected reduces the risk of developing complicity between inspectors and employers;
 - Decentralization of the inspectorate to increase proximity with employers can improve compliance rate.

What are measures to enforce compliance (combating evasion)?

- **Initiate and enforce punitive, but realistic, administrative penalties for evasion.**
 - Procedures for recovery of arrears may range from routine correspondence to court case;
 - Penalties should be high enough to deter enterprises from persistent late payment but should not be so severe to be unlikely respected, applied successfully or sustained by the courts;
 - Many schemes have a surcharge that increases progressively over the delay period. The recovery action may cost more than the amount of the fines.
- **Undertake public relations campaigns to encourage compliance.**
 - Public education campaigns can be designed to offset the myopia effect of employers and workers who undervalue the social security benefits.
- **Report regularly.**
 - Periodical reports allow stakeholders to verify that contributions have been properly remitted and recorded.
- **Enforce compliance indirectly through realistic regulations.**
 - Regulations can require employers to be in good standing with the social security scheme in order to get a business licence, bid on government contracts, receive an export licence, etc.

What are measures to enforce compliance (combating evasion)?

- **Reform scheme design.**
 - Scheme's provisions should be modified to eliminate incentives and possibility of evasion.
- **Coordinate verification and enforcement activities with the tax collection agency.**
 - Such coordination facilitates sharing data and information on properties of employers with contribution arrears, as well as identification of unregistered employers.
- **Declare amnesties to encourage evading employers to comply in the future.**
 - Frequent amnesty declarations may not promote compliance if employers anticipate a subsequent amnesty.
- **Avoid creating expectations difficult to achieve.**
 - i.e.: extension of coverage to self-employed workers can only progress slowly and requires the administering body to have the will and the capacity to enforce compliance.

What are measures to enforce compliance (combating evasion)?

- Many compliance measures are made possible or easier to implement thanks to modern information technology:
 - **Extranet** can be used for contribution remittance, information flow between the social security organization and its employers, workers and beneficiaries;
 - **Extranet and intranet** can improve the information flow between head office and regional offices. Field inspectors can have real time access to employers' information;
 - **Analytical database** requires unique registration number for each employer and each worker;
 - Employer Identification Number (EIN) can be a sequential number or have a more complex format that combines sequential number, prefix and suffix that embed useful information such as geographical area and economic activity (usually using the international standard classification);
 - The format of social security registration number of workers varies from simple sequential number to complex number including alphanumeric components;
 - Biometric system can be used to perform three different tasks - recognition, verification and identification;
 - Biometrics commonly implemented and studied include fingerprint, face, iris, voice, signature and hand geometry*.



* <https://www.dhs.gov/biometrics>

What are measures to enforce compliance (combating evasion)?

- **Analytical database applications** can issue schedules of contributions due, optimize inspection schedule and provide appropriate statistics for the management to monitor and make decision;
- **Information system** can efficiently assist the prosecution unit as several reminder notices and letter of demand are normally sent to the defaulting employer before initiating legal action;
- **Public education campaigns**
 - Can use social networks and media channels to disseminate continuous specific information in principal languages of the country to target groups, even those in the remote areas;
 - Information technology also allows virtual access to seminars, conferences and workshops periodically organized at workplaces, during trade fairs or promotional activities;
- **Well-designed database** facilitates development of tools for meeting high standards of governance (monitor and audit functions) and exchange of information among institutions.

What are measures to reduce moral hazard in workers' compensation?

- Employers and workers can have less incentive to avoid accidents because their losses are insured;
- Insurance pricing mechanisms such as employer's experience rating and industry risk base rating counterbalance employers' moral hazard effect and provide them with incentives to increase safety and control costs;
- Injured workers tend to maximize their insurance benefits;
- Limits on compensation benefits can be designed to counterbalance workers' moral hazard effect and provide them with incentives to return to work;
- Under monopolistic service provider system such as social insurance:
 - Moral hazard can arise from the social security institution under the form of:
 - Late service delivery;
 - Inefficient operation; and
 - The organization's interest put before public interest.

What are measures to reduce moral hazard in workers' compensation?

- Under competitive market system such as mandatory private insurance:
 - Employers choose insurance companies with lowest cost rather than workers' best interest in mind;
 - Service providers care for employers' cost control and their own objective of profits to the detriment of workers;
- Mechanisms that can prevent moral hazard from social insurance institution include:
 - Supervision at higher levels (e.g. line ministry, tripartite board of directors);
 - Complaint office; and
 - NGO's watch.
- To counterbalance moral hazard from private providers:
 - Supervision authorities can be put in place;
 - Participation of workers' organizations in selecting insurance companies and policies.

What does unified collection system consist of?

- A joint collection system can consist in a public agency that collects social security contributions along with income tax;
- Advantages:
 - Lower cost; and
 - Where income tax collection system is well established, the agency:
 - Has extensive infrastructure in place for collecting contributions;
 - Performing important verification, oversight, and enforcement functions.
- However, many countries maintain a separate collection of social security contributions from income tax for:
 - The particular nature of a social security scheme such as defined contributions schemes with individual accounts managed by private fund managers;
 - The income tax structure (i.e. income tax system with high threshold not readily prepared to monitor low-paid workers' evasion of their social security contributions).

What does unified collection system consist of?

- The economies of scale and efficient enforcement with a unified collection system cannot materialise unless **two critical conditions are met:**
 - There is a *strong fiscal administration*;
 - The joint collection body (generally a government body) will act solely as an *agent* which receives and transmits social security contributions to the social security organisation without delay or diversion.

This confidence can be difficult to build where government faces chronic budget deficits. In former command economy countries, the tax collection authority may not be accustomed to crediting revenues anywhere other than to the state budget.
- It is inappropriate to identify the best collection system as what makes an administrative arrangement to collect social security contributions and taxes appropriate depending on the real circumstances in the country:
 - Size and characteristics of the population;
 - Resources available to the government (financial, personnel, information technology);
 - Political time frames and other constraints; and
 - National cultural and social situation.

Additional resources

Additional readings

-  [ISSA Guidelines – Contribution Collection and Compliance](#)
-  [Social Security Contribution Collection and Compliance: Improving Governance to Extend Social Protection](#)
-  [Extending Social Security to Workers in the Informal Economy: Lessons from International Experience](#)
-  [Contribution Evasion: Implications For Social Security Pension Schemes Practical Lessons In Pension Reform: Sharing The Experiences Of Transition And OECD Countries](#)
-  [Council of Europe, European Commission - Contribution Collection Systems And Possible Measures To Improve Their Effectiveness” from the Social Institutions Support Programme](#)
-  [Pension Research Council, University of Pennsylvania - Compliance in Social Security Systems Around the World” in Prospects For Social Security Reform](#)
-  [ISSA - Administrative Issues in the Implementation Of Social Security Reform” In Interactions Of Social Security And Tax Systems, pp. 63-71](#)
-  [The Legal and Economic Evolution of Workers’ Compensation: Prospects for Enhancing Choice in The System](#)