

Stopping a snowball to reduce unemployment: The case of parafiscal payroll taxes in Colombia

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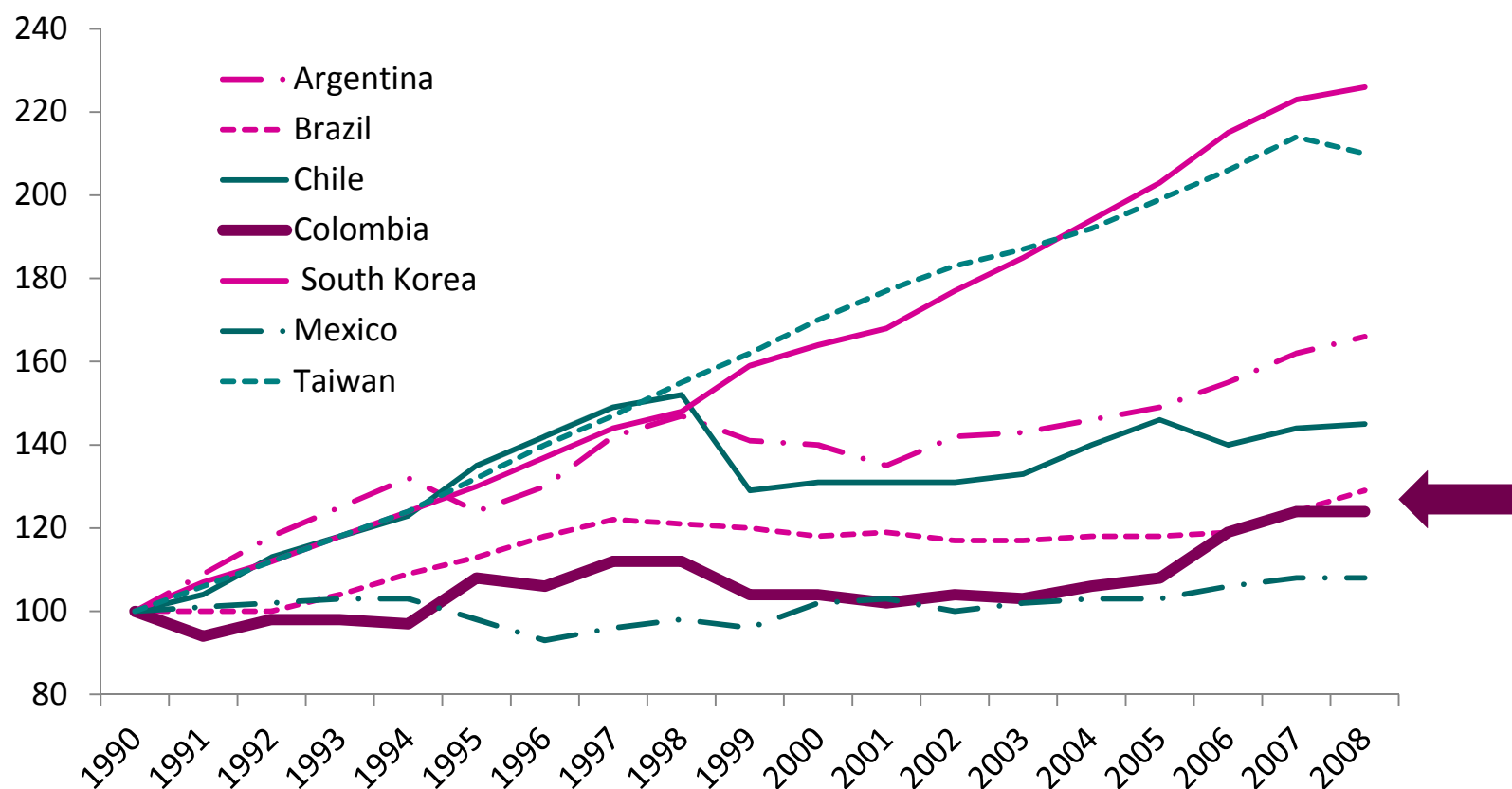
Agenda

- ① The Colombian labour market
- ② Alternatives to increase employment
- ③ Selected policy: reduction of payroll taxes
- ④ Concluding remarks

Agenda

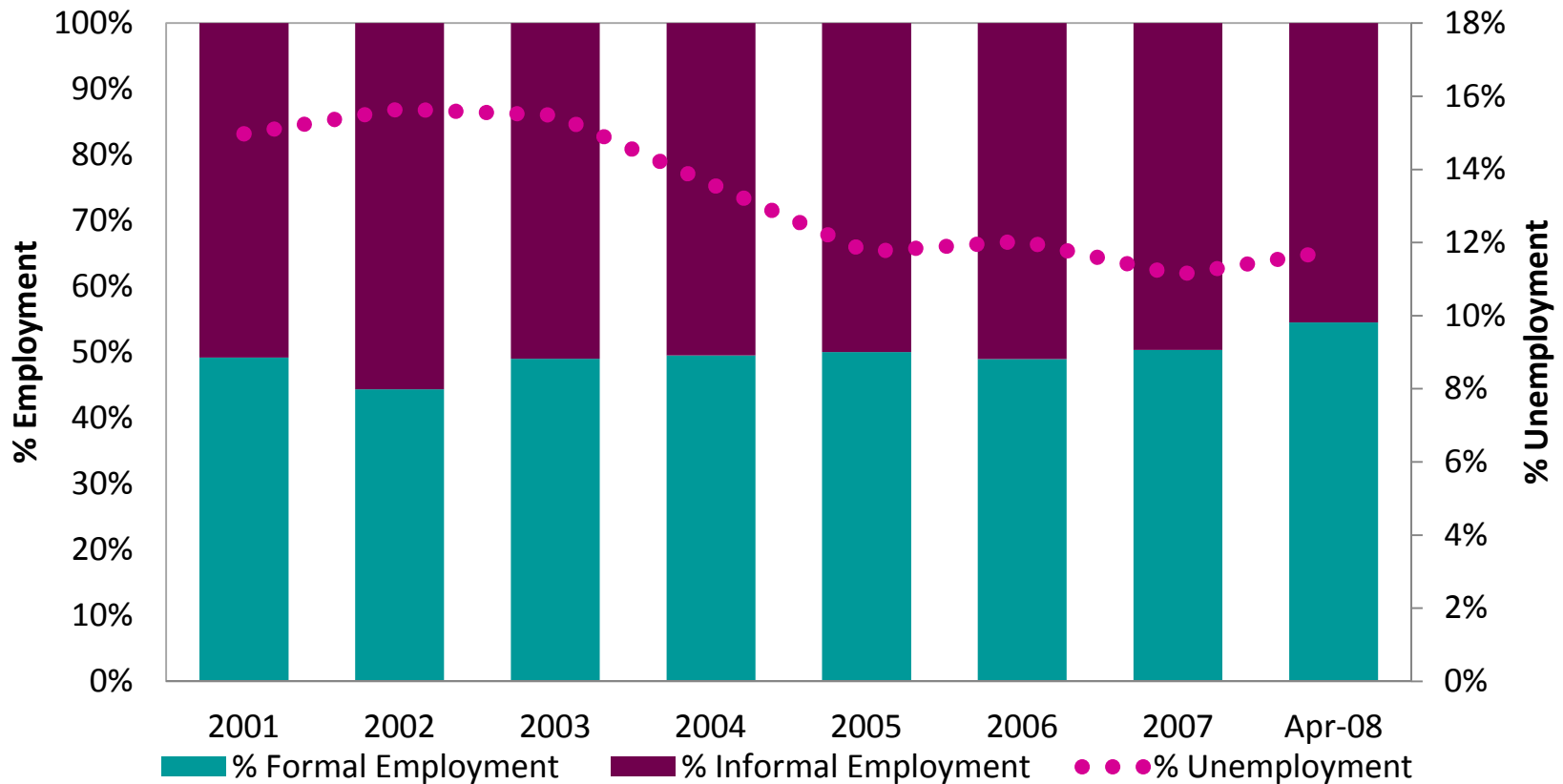
- 1 **The Colombian labour market**
- 2 Alternatives to increase employment
- 3 Selected policy: reduction of payroll taxes
- 4 Concluding remarks

In the last two decades relative productivity has decreased in terms of GDP per hour worked (ILO)



- Colombian productivity has remained fairly constant whilst other Latin American and Asian countries have increasing productivities

High unemployment and informality characterise the labour market



- Half of total employment is informal
- Unemployment is a two-digit figure, although it has decreased since 2004

1 The Colombian labour market

Recent reforms have aimed at increasing flexibility, but the economy is still not able to adjust to business cycles

1990

- Allowed for flexible contracts
- Private severance funds
- Reduced dismissal costs from 42% to 47%

Decreased unemployment by 0.4%

1993 (health reform)

- Increased health and pension payments

Overhead costs increased to 59%

2002

- Unemployment subsidy for formal workers
- Expanded the normal labour hours
- Structural changes such as subsidised health and more investment in technical education

Increased employment by 3.4%

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2 Alternatives to increase employment

Flexibilisation

Colombia has advanced in labour contract flexibilisation but still needs to provide more security to citizens

Partial Flexibilisation

- Flexible contracts
- Health, education and unemployment subsidy

Relevant experiences

- France
- Spain

Colombia

- Temporary contracts
- EATs (temporary working agencies) and «cooperativas», which are also used as temporary agencies
- Security has increased but the coverage is scant



Higher employment but lower quality

Loophole correction and transition
smoothing from health subsidy to formal
employment

2 Alternatives to increase employment

Minimum wage coordination

Colombian minimum wage coordination has led to a decrease in competitiveness and restricts formal employment

Minimum wage setting

- Coordination amongst stakeholders to attain a competitive minimum wage

Colombia

- The minimum wage is national, but it can be lower for SENA apprentices
- Negotiation is between the government and the unions, unemployed are not represented

Relevant experiences

- Scandinavian countries



Real wages have increased more than productivity

Prevent further loss in competitiveness

2 Alternatives to increase employment

Structural changes

Structural changes are taking place at a slow pace and the country is falling behind

Structural changes

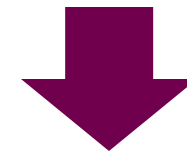
- Infrastructure investment
- Law enforcement
- National stability
- Education
- From agriculture to manufacturing and to services

Relevant experiences

- South Korea
- Taiwan

Colombia

- There has been a leap from agriculture to services
- Political instability and lack of security
- Deficient infrastructure
- Several laws and regulations but poor enforcement



Structural changes could bust productivity

Investment in infrastructure, health and education

2 Alternatives to increase employment

Payroll tax reduction

Payroll taxes distort the labour market

Payroll taxes

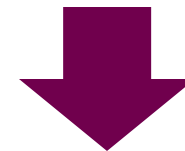
- Taxes directly linked to wages
- Increase labour costs

Relevant experiences

- Chile
- United States

Colombia

- Employers pay extra 59% of wages
- Had been reduced but then increased again by the 1993 reform
- Are the highest in the region
- Affect employment but not wages



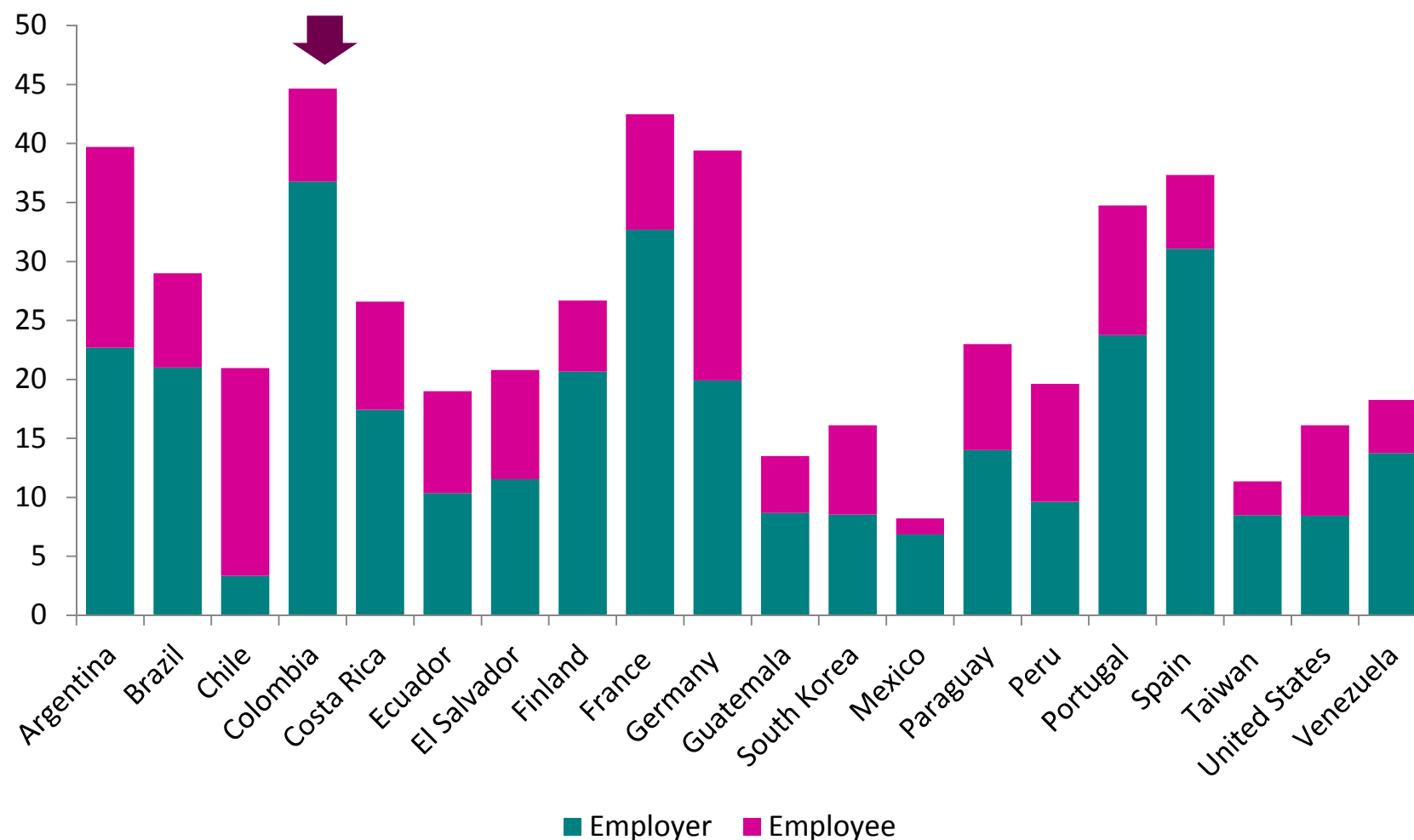
There is an opportunity to increase competitiveness and employment through a reduction of payroll taxes

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3 Selected policy recommendation

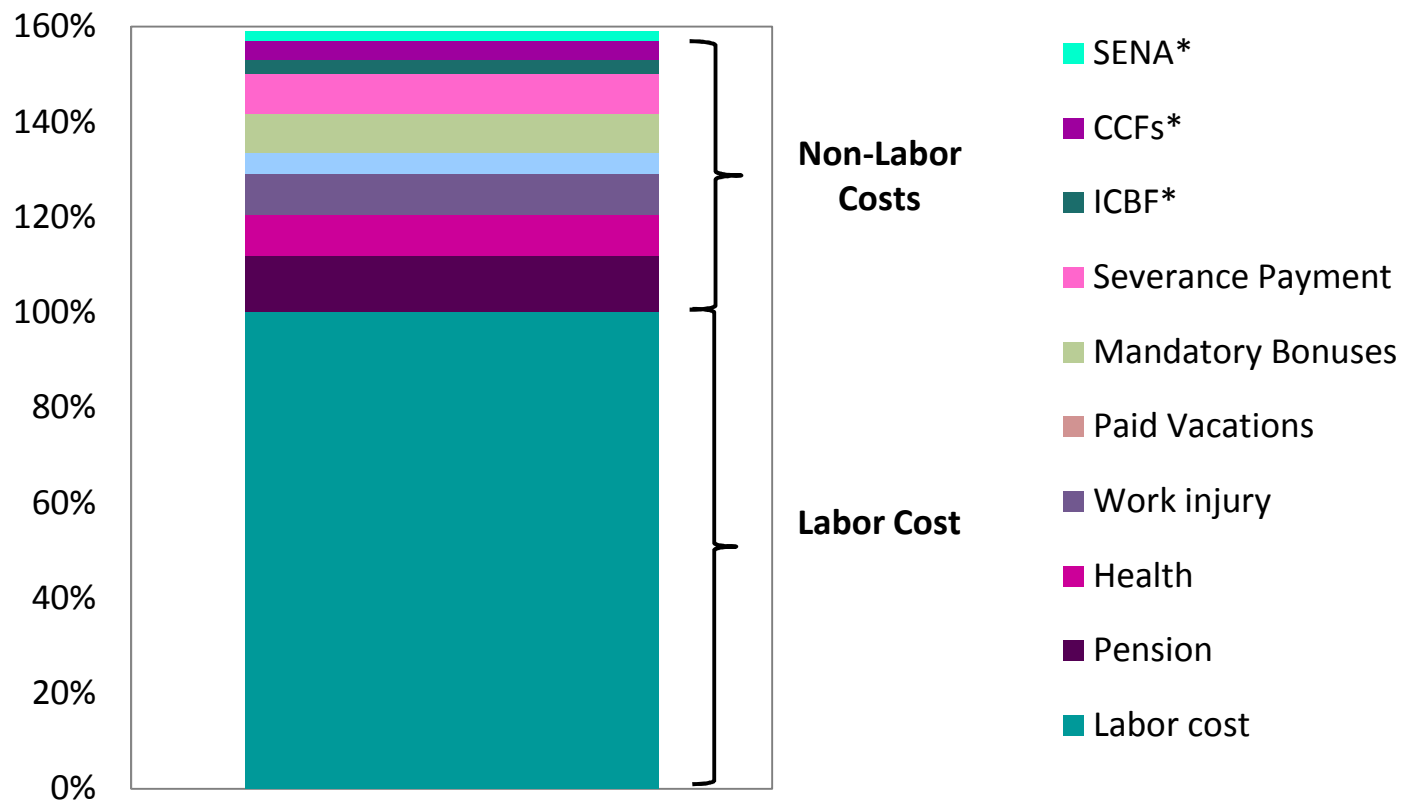
Social Security contributions are extremely high compared to other countries



- Employers pay 82% of social security
- In addition, parafiscal payments also increase the non-labour costs

3 Selected policy recommendation

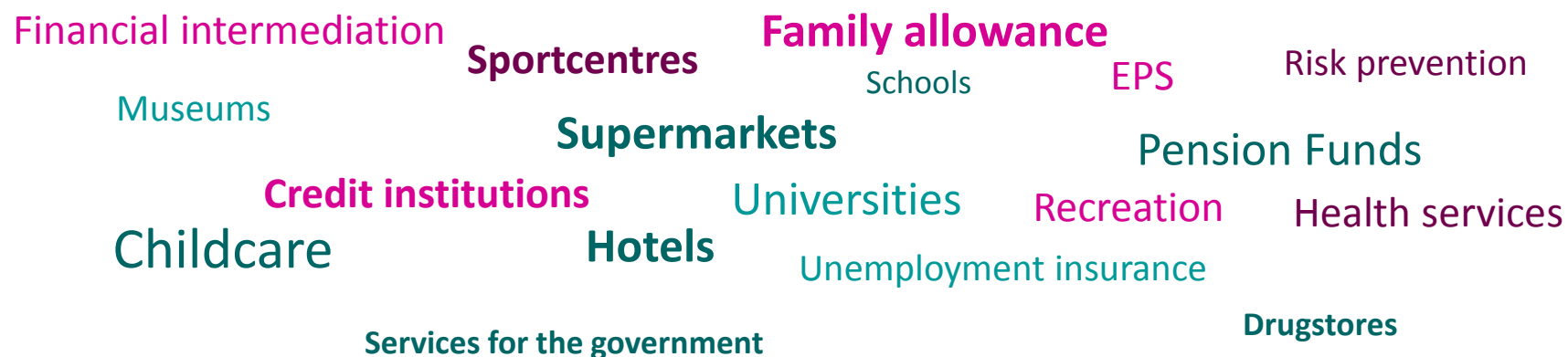
Payroll taxes account for 59% extra costs and are distributed amongst several public and private institutions



- Parafiscal payments account for 9 percentage points of the non-labour costs: SENA (2%) is the National Apprenticeship Service, ICBF (3%) is the Colombian institution for family welfare and CCFs (4%) are non-profit organisations

CCFs are required but they have excess resources and scant regulation

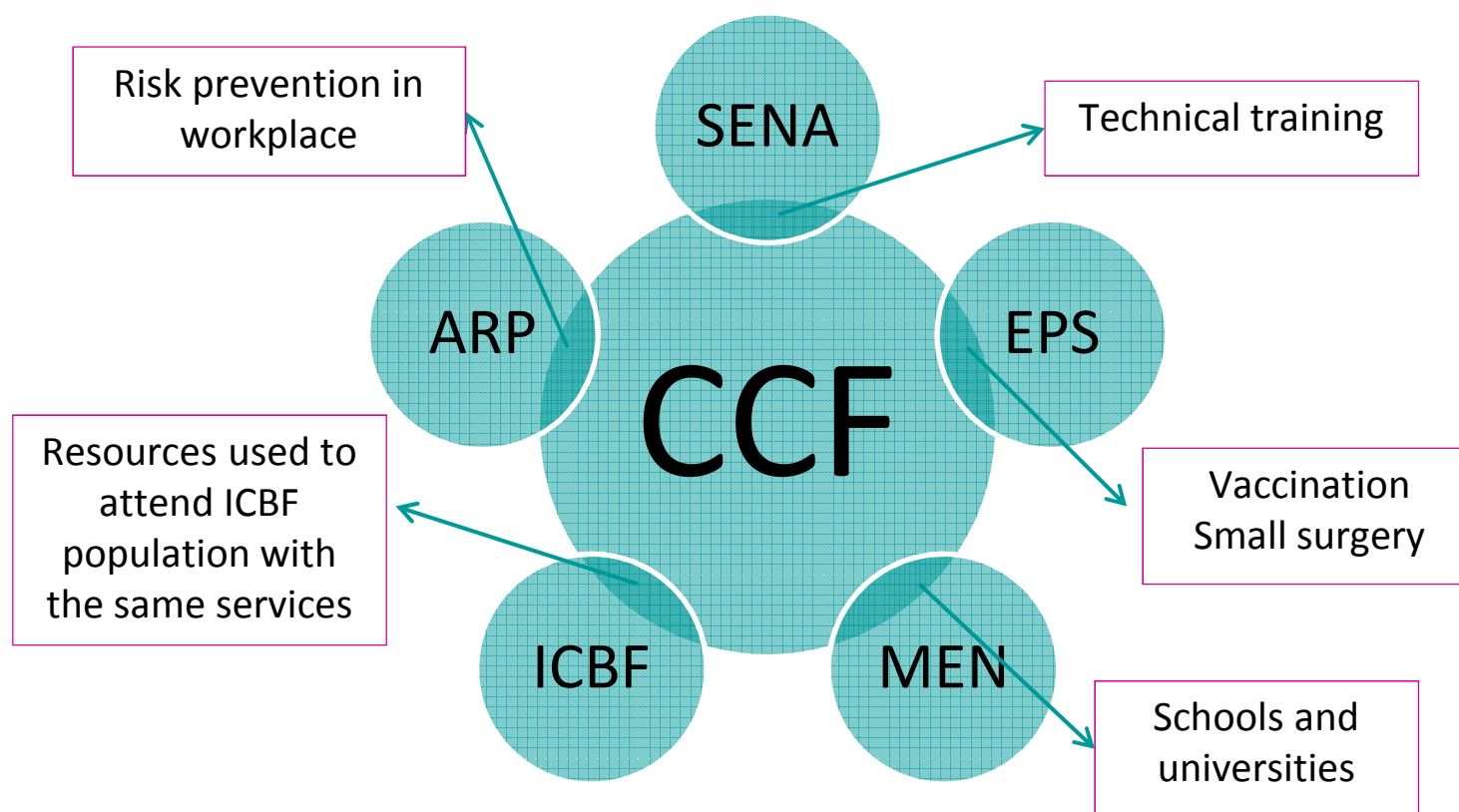
- They were created by private motivation in 1954 and giving them 4% of wages soon became mandatory
- Their aim is to improve welfare of employees and their families



- They invest taxes, though are not subject to the norms and controls established
- Those taxes benefit almost solely the affiliates, not informal workers
- They distort the markets by providing subsidised goods and services
- Large investments in capital have high opportunity costs

3 Selected policy recommendation

Investments are inefficient: they overlap with other institutions, lack of central planning and even some are unnecessary



- There are 45 CCFs, several which are present in the same regions
- They should not need to invest in infrastructure if they bought the goods and services
- Five-star hotels and luxury supermarkets should not be provided with taxes

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- Informal workers, excluded from the benefits of CCFs, are the most affected
- Although it could be unpopular, if it is not stopped the problem would just keep on growing
 - Negotiation has to favour those who lose (union members)
- Ideally we would recommend a reformulation of Colombian tax structure in order to rely less on payroll taxes