



Tackling Insecurity in Old Age: The Challenge of Universal Pensions

Deteriorating health and declining incomes threaten the welfare and security of many people as they enter old age. Nearly 80 per cent of older persons living in developing countries (about 342 million people) lack adequate income security, a figure that could, according to the *World Economic and Social Survey 2007* (<http://www.un.org/esa/policy/wess>), rise to 1.2 billion by 2050 if pension coverage does not keep pace with demographic changes. The *Survey* suggests that a minimal universal social pension provides the surest way to tackle the problem. Universal pensions would provide a floor below which nobody could fall. Moreover, they could provide the basis for a more comprehensive pension system which may consist of a mixture of public and private initiatives adapted in accordance with existing country practices, financial circumstances and equity considerations.

Poverty and Old Age

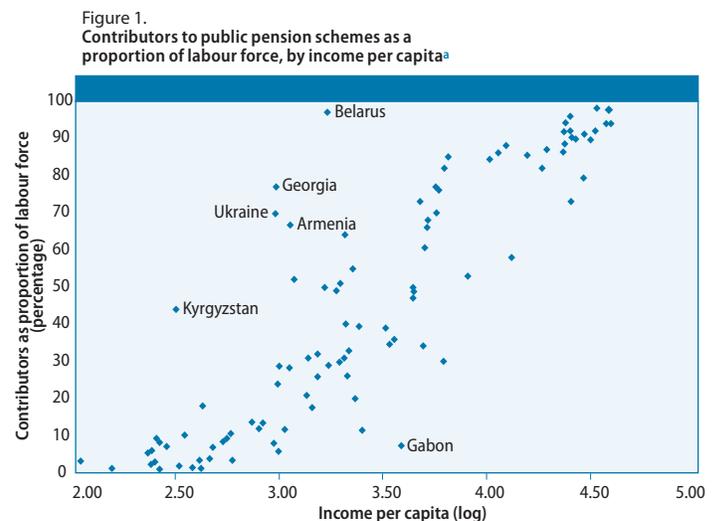
Retirement is still very much the preserve of older citizens in wealthy countries, thanks to the creation and expansion of public pension systems and the accumulation of financial assets during their working life. Both of these have combined to produce a declining incidence of poverty among older persons in the United States, for example, from 35 per cent in 1960 to less than 10 per cent today.

In the absence of such transfer mechanisms, the risk of spending old age in poverty rises sharply. In most developing countries, many older persons must continue working to maintain living standards, although limited job opportunities, lower wages and physical impairment combine to restrict earning power. The problem is particularly acute in rural areas, and tends to affect older women more than their male counterparts. In some parts of the world, notably in sub-Saharan Africa, the problem is compounded owing to the added responsibility of child care placed on grandparents resulting from the HIV/AIDS pandemic.

Ad hoc transfers from social networks and family members, particularly children, can provide additional security to older people. However, these are not guaranteed and are likely to decline with reductions in family size, changing social attitudes and a more uncertain economic climate. Whether poverty in old age can be avoided will therefore depend on extending the coverage of more formalized pension schemes.

Universality Matters

There are large differences in formal pension systems, even among advanced countries, in terms of their coverage, benefits provision and funding patterns. However, in all cases, a commitment to universality matters. This is clearly illustrated in transition economies such as Armenia, Belarus and Kyrgyzstan, where pension coverage is much higher than predicted by their income levels (figure 1).



Source: *World Economic and Social Survey 2007: Development in an Ageing World*, figure V.2. a Latest observations between 1988 and 1998.

Lower coverage elsewhere is partly the result of the way in which contributions are managed. Typically, contributory approaches only cover the formal sector and may in fact only provide benefits to specific workers, for example in the public sector or certain professions. Where the formal economy is stagnant or shrinking, as has been the case in parts of Africa and Latin America, coverage is inevitably threatened.

Several developing countries have, in recent years, introduced social pensions that provide some minimal basic income security to all persons in old age. In these schemes, eligibility is not conditional upon having previously contributed, but rather upon reaching a certain age; in Bolivia, Botswana and Mauritius, for example, pensions are granted to all upon reaching 65 years of age. In other countries, such as Argentina, Namibia and South Africa, eligibility is subject to a means test. All such non-contributory schemes are either financed through general taxation, through special levies on specific activities or sectors or through “solidarity” tax or contributions on earnings by

those participating in earnings-related pensions.

The evidence suggests that such initiatives can significantly reduce poverty amongst older persons. For instance, in Brazil the incidence of rural poverty among those receiving a social pension is 3.5 per cent but would be as high as 51 per cent in their absence. Similarly, the universal pension scheme in Mauritius has reduced poverty among older persons by more than 40 per cent.

Moreover, such pension benefits are often shared with household and family members. For example, in Namibia, more than 70 per cent of pension income is shared among household members and spent on food and education for grandchildren. In Bolivia, higher caloric consumption as well as lower school drop-out rates were observed in rural households benefiting from the universal pension benefit. In Brazil, the rural pension has been linked to higher expenditure on seeds and tools to support agriculture production as well as improved access to credit by beneficiary households.

How to pay for universal pensions?

For many countries, a universal transfer equal to the poverty line granted to all those above a certain age and funded out of general taxation or some specific earmarked tax would contribute significantly to increasing income security. However, there is a growing perception in developed, as much as in developing countries, that demographic pressures are making existing pension schemes unaffordable and preclude further moves to extend coverage.

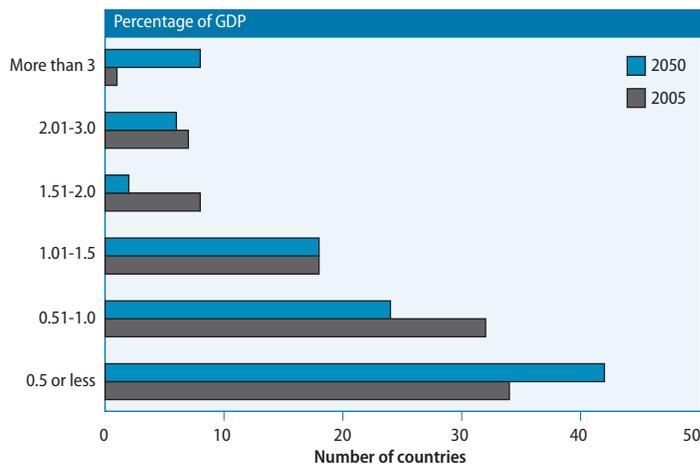
This perception of unaffordable pension schemes seems unduly pessimistic. Simple fine tuning, such as increasing the retirement age or altering fiscal incentives can quickly alleviate the financial pressure on pension systems in the more advanced countries. Moreover, drastic reforms, such as shifting from publicly administered pay-as-you-go schemes to privately managed fully funded schemes, may not bring the desired improvements; higher-than-anticipated transition and administrative costs, lower-than-expected returns and reduced coverage have reduced the benefit of such reform efforts.

Of course, robust growth and the provision of good jobs are as fundamental for the sustainability of the pension regime as the design of the regime itself. This is especially true in developing countries where an increase in formal sector employment widens access to pensions by extending participation in contributory schemes and strengthening fiscal positions.

Still, the cost of providing a universal minimum non-contributory pension to older persons that is sufficiently high to eradicate extreme poverty amongst older persons does not appear to be very high. According to estimates in the *Survey*, for 66 out of 100 countries considered, the cost of eliminat-

ing extreme poverty of older persons by granting a pension equivalent to \$1 per day (expressed in purchasing power parity terms) to all those over 60 years of age, would have been equivalent to less than 1 per cent of their respective GDP in 2005. For 34 countries, it would in fact have cost less than half a per cent of GDP. Despite increasing populations, the cost would still amount to less than 1 per cent of GDP in 18 countries by 2050 (see figure 2).

Figure 2.
Simulated costs for developing countries of a universal social pension scheme designed to keep older persons out of extreme poverty, 2005 and 2050



Source: World Economic and Social Survey 2007: Development in an Ageing World, figure V.3.

Notwithstanding their relatively low cost, and even assuming growth begins to pick up, social pensions may still be out of reach for some low-income countries owing to a limited fiscal base and the competing demands from other social goals. For instance, even the 1 per cent of GDP figure, would still correspond to 10 per cent of tax revenues in Cameroon, Guatemala and India, among others, and would be equivalent to existing health expenditure in Bangladesh, Burundi and Côte d'Ivoire, to name a few. Costs can be lowered by increasing age eligibility, such as in Nepal, where benefits are available to those over 75, or by introducing differentiated benefits that increase with age.

In those cases where it is impossible to find the necessary fiscal space, the donor community might seek ways of directly subsidizing non-contributory pensions in some countries as part of their strategy to alleviate extreme poverty. ■

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