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UNIVERSAL NON-CONTRIBUTORY PENSION SCHEMES FOR LOW-INCOME COUNTRIES: AN ASSESSMENT

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1. INTRODUCTION

By 2050, the size of the global elder population is expected to reach close to 1.6 billion (see Figure 1) (United Nations, 2005b). The public discourse about how to prepare for the burgeoning elder population has largely focused on the projected financial insolvency of old-age public pension systems in many high-income countries. Despite the fact that less developed countries are projected to make a far greater contribution to the global elder population than will more developed countries, a topic that has received less attention is the lack of old-age social security coverage in large portions of many less developed countries.

Old-age pension coverage rates are low in many low-income countries (Barrientos, 2006; Bertranou et al, 2004). In India, less than 10% of the population in many areas is eligible for public old-age social security (Gillion et al, 2000). Approximately 6% of the population is covered in Tanzania (Mchomvu et al, 2002). Low old-age pension coverage contributes to the growing problem of old-age destitution in low-income countries. In many African countries, households with elderly members are more likely to live in poverty than other households, particularly in rural areas (Kakwani & Subbarao, 2005).

Informal sector employment contributes to low old-age social security coverage (Bertranou, 2002; Charlton, 2005; Maes, 2003; Robalino et al, 2006). Labor informality is high and on the rise in many parts of the world (Bertranou et al, 2004; Robalino et al, 2006; van Ginneken, 2003). Approximately 90% of all new urban jobs in Africa in the 1990s were in the informal sector (International

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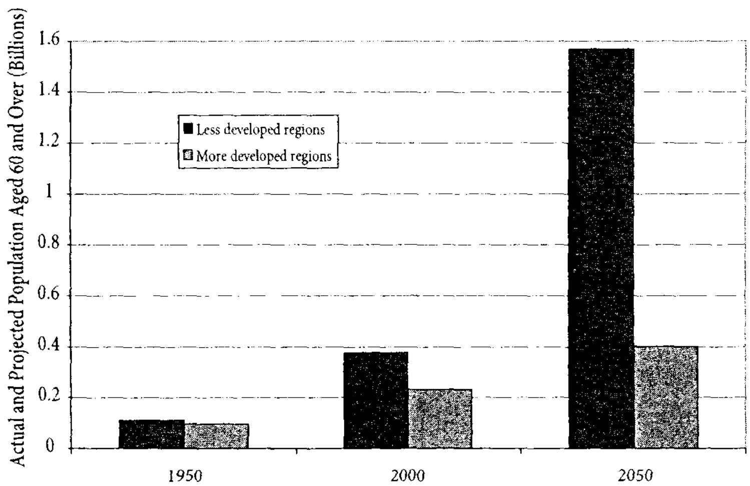
Labour Office, 1999; McKinnon, 2005). In Latin America, between 35% and 60% of all jobs are in the informal economy (Bertanou & Rofman, 2002). In India, most workers have seasonal, casual, or temporary jobs (Kumar, 2003). In Eastern Africa, 90% of the workforce is in the informal economy (Dau, 2003). Women are particularly vulnerable to informality (Lund, 2002b; Van Zyl, 2003).

Figure 1. Size of the Population Aged 60 or Over in Less and More Developed Regions



Source: Based on authors' calculations using data from United Nations (2005b).

Many countries lack the legal infrastructure and administrative capacity to extend contributory old-age social security coverage. Access to contributory pension systems is typically limited to government employees or workers at large-scale organizations in urban areas. Foreign workers, who represent a large portion of the workforce in Middle Eastern countries, are legally ineligible for contributory pension coverage (Turner & Lichtenstein, 2002). Many informal sector, part-time, and temporary workers have limited or no access to such schemes (Lund, 2002b). Many of those who do have access choose not to participate because they are too poor to make contributions, lack trust in administrators, or see little correspondence between their contributions and future benefits (Gill et al, 2005; van Ginneken, 1999b). Sources of mistrust include benefit delays and lack of transparency about benefit levels and investment decisions (Dau, 2003; Mchomvu et al, 2002). Approximately 20% of formal sector workers in South Africa choose not to participate in contributory pension schemes that are available to them (Van Zyl, 2003). Contribution evasion is also a major problem in developing countries (McGillivray, 2001; McKinnon, 2005).

Administrative capacity is often a barrier to coverage in rural areas. The structures required to collect taxes and contributions and maintain records are simply non-existent in many cases (Jütting, 2000). Rural elders often live in remote locations, where transportation and communication costs are viewed as prohibitive. Unpredictable and low incomes limit the extent to which rural inhabitants are able to make contributions to statutory pension schemes. Language differences are also a barrier for rural elders (Maes, 2003). Finally, rural elders have a weaker political voice than urban elders, and are thus unable to advocate for extended coverage (Jütting, 1999).

Access to old-age statutory pension coverage is typically higher in urban areas than in rural areas, but it is still low in many urban parts of low-income countries (Maes, 2003). Most covered work in Tanzania is in the urban formal sector (Mchomvu et al, 2002). Urban elders are, however, less likely to have access to certain family supports than are their rural counterparts (Kabir et al, 2002). Political, economic, and social stratification contribute to the weak community cohesion in urban areas (van Ginneken, 1999a).

Several policy approaches have been proposed to deal with the problem of low old-age social security coverage (Holzmann, 2004; Jütting, 2000; Morduch, 1999). One option is to encourage families and other support networks to continue caring for their elders. Traditionally, elders find social security with their children or other domestic or kinship ties (Kakwani & Subbarao, 2005; Mchomvu et al, 2002; Unni & Rani, 2001; Williamson & Pampel, 1998). Urbanization, migration, industrialization, and HIV-AIDS are breaking down these social support networks (Jütting, 1999; Kakwani & Subbarao, 2005; Kumar, 2003; Overbye, 2005).

Another option is to support the development of micro-insurance plans or mutual aid societies via partnerships with large-scale commercial insurance companies or regional or national public sector entities (Cichon et al, 2003; Loewe, 2006; McKinnon, 2005; McKinnon & Sigg, 2003). Such organizations pool resources and provide members with loans, medical assistance, and emergency aid (Morduch, 1999; Unni & Rani, 2001). One limitation of these locally-operated groups is that they depend on the ability of participants to make contributions (Mchomvu et al, 2002). In addition, they are susceptible to several insurance inefficiencies, such as moral hazard, adverse selection, and risks that affect several individuals simultaneously, like crop failure (Jütting, 2000). In urban areas, where individuals are likely to know less about their community members than in rural areas, moral hazard and adverse selection, insurance inefficiencies that result from information asymmetry, may pose a challenge to the efficient operation of micro-insurance plans or mutual aid societies. In rural areas, covariant risks are of particular concern.

Table 1. Characteristics of Countries with Universal Non-Contributory Pensions

Country	Population in Millions in 2005[a]	Percent of the Population Aged 60 and Above in 2005 (%)[b]	Rural Population as a Percent of Total Population in 2003 (%)[a]	Annual Rural Population Growth Rate in 2003 (%)[a]	Urban Population as a Percent of Total Population in 2003 (%)[a]	Annual Urban Population Growth Rate in 2003 (%)[a]	Gross Domestic Product (GDP) in Millions in 2004 (US$)[a]	GDP Per Capita in 2004 (US$)[c]	Universal Non-Contributory (UNC) Pension Eligibility Age	Monthly UNC Pension Amount (US$)[g]	UNC Pension Expenditure as a Percentage of GDP
Bolivia	9.2	6.7	36.0	0.4	64.0	2.8	8,713	935	65[d]	21[g]	1.30[gn]
Botswana	1.8	5.1	49.7	-0.2	50.3	1.5	8,974	4,771	65[e]	24[g]	0.40[g]
Lesotho	1.8	7.5	69.7	-0.2	30.3	3.6	1,367	764	70[f]	22[j]	1.43[j]
Mauritius	1.2	9.6	57.7	0.4	42.3	1.8	6,038	5,123	60[e]	72[kl]	2.00[g]
Namibia	2.0	5.3	67.6	0.7	32.4	3.2	5,712	2,661	60[g]	26[g]	0.70[g]
Nepal	27.1	5.8	87.1	1.8	12.9	5.1	6,716	245	75[h]	2[g]	0.10[g]
Samoa	0.2	6.5	77.2	0.7	22.8	2.1	357	1,968	65[h]	30[m]	0.60[ln]

[a] Source: World Bank (2005).
[b] Source: United Nations (2005b).
[c] Source: United Nations (2005a).
[d] Source: International Social Security Association (2006).
[e] Source: International Social Security Association (2005a).
[f] Source: International Labour Organization (2006b).
[g] Source: Willmore (2001).
[h] Source: International Social Security Association (2005b).
[i] These values are in 2005 U.S. dollars.
[j] HelpAge International (2006).
[k] Willmore (2006b).
[l] This value represents the monthly pension for individuals aged 60–74.
[m] Source: McKinnon & Sigg (2003).
[n] This value is estimated.

A third option to consider is non-contributory social security. Despite the recent international movement toward pension privatization, non-contributory pension models are receiving an increasing amount of attention from some policy-makers and analysts interested in poverty reduction via the expansion of old-age social security coverage (Charlton, 2005; Gill et al, 2005; Johnson & Williamson, 2006; McKinnon, 2005; Shen & Williamson, 2006; Willmore, 2006a; Willmore, 2006b). The World Bank recently called for the expansion of "zero pillar" old-age social security strategies, which are any non-contributory, tax-financed, universal or means-tested forms of old-age social security (Holzmann & Hinz, 2005).

Non-contributory pensions exist in several low-income countries. Beneficiaries do not make contributions to these plans; instead, these plans are typically financed with general tax revenues. Developing countries with means-tested non-contributory plans include Argentina, Bangladesh, Brazil, Chile, Costa Rica, India, South Africa, Sri Lanka, and Uruguay (Holzmann & Hinz, 2005). The goal of our analysis is to assess the utility and feasibility of universal non-contributory pension plans as vehicles for providing income security benefits to elders who meet age and residency requirements in low-income countries. We contend that these plans show potential for many more developing countries than the seven listed in Table 1. The feasibility of universal non-contributory pension plans will often differ between rural and urban regions of low-income countries.

2. BENEFITS AND LIMITATIONS OF NON-CONTRIBUTORY PENSIONS

The potential benefits of non-contributory pensions for rural and urban elders and their communities are substantial. First and foremost, they are known to extend old-age social security coverage and prevent and reduce poverty. Non-contributory pensions in Bolivia play a crucial role in helping elders obtain food, housing, and medical services (Skinner, 2006). Poverty rates among elders in Brazil and South Africa are 3% and 4% lower, respectively, because of the availability of non-contributory pension benefits (Barrientos, 2003). Policy simulation analyses show that both means-tested and universal non-contributory pensions would reduce the poverty headcount drastically in several African countries if employed (Kakwani & Subbarao, 2005).

Non-contributory pensions systems benefit countries, communities, and individuals politically, economically, and socially. States are encouraged to develop administrative structures to track the distribution of benefits and determine eligibility. As a result, government transactions become more transparent and accountable to community members. Citizens are thus more trusting of their governments and willing to participate in community affairs

(Gorman, 2004). Communities benefit economically as business owners and farmers use their pension benefits to invest in new capital (Gorman, 2004). Pension distribution points bring neighbours together and operate as centres for local trade and business transactions (Gorman, 2004; Lund, 2002a). The family members of pension recipients benefit economically, as well. For example, in areas where employment opportunities are lacking, non-contributory pension benefits provide elders with the security they need in order to permit family members to migrate elsewhere for employment (Barrientos & Lloyd-Sherlock, 2003). Elders and their family members are also able to use their non-contributory pension benefits to access the medical services and nutrition that they need to maintain good health (Duflo, 2003; Duflo, 2000). The benefits and their byproducts ultimately advance the status of elders in their societies and increase feelings of self-worth (Barrientos & Lloyd-Sherlock, 2003; Gorman, 2004).

Non-contributory pensions have some limitations. Some consider them to be less reliable than other forms of old-age social security because they are subject to the availability of government funding (Rajan, 2002). They may also discourage participation in contributory social security schemes (Bertranou et al, 2004). Another limitation is that they may cause families and communities to feel less responsible for the economic security of their elders (Jensen, 2003). Finally, at times, elders with access to non-contributory pensions are vulnerable to financial or other abuse (Joubert et al, 2002).

3. TESTING MEANS IN RURAL AND URBAN AREAS

A country's decision about whether to provide non-contributory pensions on a means-tested or universal basis entails consideration of several administrative, political, and financial issues. Administratively, testing means requires more resources and capacity than does providing benefits on a universal basis (Barrientos & Lloyd-Sherlock, 2003; Gorman, 2004; Overbye, 2005; Willmore, 2001; World Bank, 1994). Both means-tested and universal non-contributory pension systems require access to accurate and complete information about individuals' age and residency status. A universal pension is awarded to all individuals who meet designated age and residency requirements. Means-testing requires additional reliable information about individuals' income and assets, since a means-tested pension is awarded upon determining that an individual's income and assets fall below certain designated amounts. Namibia has chosen not to test means because accurate information about elders' incomes is not always available (Schleberger, 2002).

Cost is a major point of interest for administrators of non-contributory public pensions. Critics worry that universal non-contributory pensions are too expensive (World Bank, 1994). However, often overlooked is the fact that faulty targeting and high administrative expenses substantially increase the cost of means-tested schemes (Heslop, 2002; Willmore, 2001). In addition, faulty targeting can leave many elders impoverished (Bertranou, 2002).

Universal distribution mechanisms tend to be more politically popular than means-testing, particularly when general tax dollars are used to fund the pensions (Devereux, 2001). Tax-payers believe that they should benefit from a system into which they are paying. Another political issue that may influence a country's decision about whether to test means is the extent to which government processes are transparent and citizens trust government officials. Universal pensions are thought to be less prone to corruption and fraud than are means-tested pensions (Gorman, 2004; Holzmann & Hinz, 2005; Willmore, 2001). Mauritius removed its non-contributory pension means-test because corruption rates were so high (Willmore, 2003).

The byproducts of means-testing are of concern to some critics. Universal pensions are thought to be less likely than means-tested pensions to discourage employment, saving, and participation in contributory old-age pension systems (Barrientos & Lloyd-Sherlock, 2003; Gorman, 2004; Overbye, 2005; Willmore, 2001). Also, in some communities, means-testing places a social stigma on recipients (Willmore, 2001; World Bank, 1994).

The issues that challenge the feasibility of means-testing are likely to be less prominent in urban areas than in rural areas of low-income countries. Urban areas are often administratively stronger than rural areas in low-income countries (Jütting, 2000). In addition, employment formality is more common in urban areas than in rural areas (Jütting, 1999), which likely makes accurate income and asset documentation easier to find in urban areas. However, the evidence that urban areas generally have more administrative capacity than rural areas does not preclude the introduction of universal non-contributory pension systems in urban areas. Mexico City's urban universal non-contributory pension system is widely popular and policy-makers have thought about expanding it throughout the country (Scott, 2005).

4. FACTORS FOSTERING SUCCESSFUL NON-CONTRIBUTORY PENSION SCHEMES

When and where is the introduction of a universal non-contributory pension system on its own or as part of a multi-pillar scheme likely to succeed? The first issue to consider is whether the political and policy environment in a country is suitable. Political will has been an important factor in the development of universal non-contributory pensions (Willmore, 2001). While India's National Old Age

Pension system is means-tested, its implementation experience serves as a useful lesson. Lack of political will has contributed to its inefficient administration (Kumar & Subbayamma, 2001). Social history and political priorities will influence how a country prioritizes the needs of its citizens and allocates available resources. Countries that value individual responsibility for well-being in later life may be less likely to support a universal non-contributory pension system than will countries with strong tendencies toward intergenerational and community responsibility for elders.

Countries will need to consider how a new universal non-contributory pension system will interface with existing old-age social security programs, so as to minimize unanticipated adverse consequences. If the size of the universal non-contributory pension payment approximates the size of a typical contributory pension payment, then workers may choose not to participate in contributory schemes (Bertranou, 2002; Bertranou et al, 2004). Countries may also consider the many other policy goals that might be served with a universal non-contributory pension system. For example, elders with access to universal non-contributory pensions may be more likely than they would be otherwise to support foster children or family members with HIV-AIDS (Barrientos & Lloyd-Sherlock, 2003; Duflo, 2000; Gorman, 2004; Lund, 2002a; McKinnon & Sigg, 2003).

If the universal non-contributory pension system is going to be available for some regions, but not others, policy-makers will need to convince those living in other regions that the pension system is fair. The urban population will need to be convinced that a pension for rural elders is a good use of general tax dollars, particularly in countries where urban workers are more likely to pay taxes than rural workers because of the low levels of formal employment in rural areas. Urban workers may be more easily persuaded when many have ageing parents living in rural areas. Similarly, the rural population may need to be convinced if a pension system is to be limited to elders in urban areas, when, for example, the necessary administrative structures are in place in urban, but not rural areas. Universal non-contributory pensions may be less crucial in rural areas if the rural population is rapidly declining (Holzmann & Hinz, 2005). The rural populations in countries with existing universal non-contributory pension schemes are growing or remaining quite stable (see Table 1). In addition, universal non-contributory pensions may be less crucial in rural or urban areas where employment formality is on the rise (Holzmann & Hinz, 2005).

5. UNIVERSAL NON-CONTRIBUTORY PENSIONS AND ADMINISTRATIVE FEASIBILITY

In order to administer universal non-contributory pension schemes, countries will need mechanisms to determine the age and residency status of each applicant. In addition, strategies to minimize corruption and fraud are necessary. Countries will also need resources to deliver the pension benefits to elders in a reliable fashion. The extent to which countries are sufficiently prepared to administer a universal non-contributory pension is likely to be greater in urban areas than in rural areas of low-income countries.

Some creative administrative strategies employed by countries that currently have universal non-contributory pension systems will prove useful in both rural and urban parts of low-income countries. In Nepal, a country largely lacking accurate birth and death records, election identity cards and horoscopes qualify as proof of age (Gorman, 2004). In Boliva, witnesses are qualified to verify elders' age (Gorman, 2004). For countries with sufficient financial capacity, fingerprinting identification technology may be a worthwhile investment. Such technology has effectively reduced fraudulent behavior in connection with the accurate identification of pension beneficiaries in Namibia (Devereux, 2001; Willmore, 2003).

A particular concern for rural communities is how the pensions will be distributed. If rural elders have access to dependable banking or postal service, countries may choose to deliver the pensions via bank or mail transactions, as with Brazil's rural means-tested non-contributory pensions (Schwarzer & Querino, 2002). A private company is hired in Namibia to distribute universal non-contributory pension benefits. United Africa Pay Masters transports the pensions to beneficiaries at pension distribution centers across Namibia using armed vehicles (Devereux, 2001). Both types of systems call for a collaborative relationship between central managers and local operators. For example, in Namibia, national managers track payments using a central database, but rely on local District Pension Officers to determine applicants' eligibility (Devereaux, 2001). Countries with very remote rural areas may need to manage their universal non-contributory pension systems in a more decentralized fashion. Rural Village Development Committees determine applicants' eligibility and pay benefits directly in cash (Rajan, 2003). Such an arrangement necessitates trust in local operators. Pension distribution is less of a concern in urban areas, where individuals live in close proximity to one another and have easier access to city centers.

A country with a minimal level of administrative capacity may choose to install a universal non-contributory pension scheme gradually. One strategy is to start with urban areas and expand to rural areas as administrative capacity develops. Another option is to start with the poorest regions of the country, so that elders in most need are served first. Countries may also choose to identify a very high eligibility age and expand to younger groups when more resources are in place, as in Nepal (Gorman, 2004). Universal non-contributory pensions are not appropriate for all countries and some very poor countries will simply lack the administrative capacity to install even a small version of a universal non-contributory pension in any rural or urban area.

6. UNIVERSAL NON-CONTRIBUTORY PENSIONS AND FINANCIAL AFFORDABILITY

Financial capacity may prevent some very poor countries from introducing a universal non-contributory pension system. However, as illustrated in Table 1, low-income countries are able to support their universal non-contributory pension systems with less than 3% of their Gross Domestic Product (GDP) (Barrientos & Lloyd-Sherlock, 2003; McKinnon, 2005; McKinnon & Sigg, 2003; Willmore, 2001). Lesotho, the most recent country to introduce a universal non-contributory pension scheme, spends approximately 1.43% of its GDP on the pensions (HelpAge International, 2006). Current estimates suggest that if the universal non-contributory pension scheme in Mexico City were expanded to the entire country, it would cost.35% of Mexico's GDP (Scott, 2005). A country's pension costs might grow with the growth of ageing populations, but so should the country's GDP (Scott, 2005; Willmore, 2001). Therefore, the cost of universal non-contributory pensions should represent a stable proportion of the GDP over time.

Funding for universal non-contributory pension schemes comes from a variety of sources. Namibia relies on general tax dollars (Devereux, 2001). Returns on government shares of privatized enterprises are used to pay for the BONOSOL in Bolivia (Gorman, 2004). Funding strategies employed by countries with means-tested non-contributory pension schemes may prove useful. For example, employer contributions and taxes on particular goods add to the pool of resources available for Costa Rica's means-tested system (Bertranou, 2002). International donations may serve as a potential source of funding for universal non-contributory pensions (Clunies-Ross, 2004; Gorman, 2004). Countries may also choose to keep costs down by starting with a small group of elders, like those living in urban areas where administrative structures are in place, or with a small benefit.

For countries with very limited financial resources, even small benefits are likely to make a difference in the lives of elders. Approximately 40% of Nepalese universal non-contributory pension recipients report that the pension covers their basic living expenses (Rajan, 2003). Bolivians staunchly protested the temporary termination of their universal non-contributory pension system (Gorman, 2004). Such resources are also likely to have beneficial byproducts for the families of elder recipients.

Prior to the introduction of a universal non-contributory pension system, countries should think about how they will handle the pension during economic crises. Elders may suffer if they do not have access to a pension on which they come to rely. Countries may choose to adjust the pension in accordance with some formula tied to economic indicators. In addition, countries will need to think about how to protect the health and educational needs of their citizens if the pension system requires that resources be redistributed from other social programs.

7. CONCLUSION

Old-age social security coverage rates are low in many parts of low-income countries, leaving numerous elders vulnerable in later life. As populations age, the lack of old-age social security coverage will likely contribute to increasing old-age poverty and destitution. Governments must act fast to develop strategies to protect elders in uncovered areas. The universal non-contributory pension scheme may not succeed in all low-income countries, but it deserves much more attention than it has received thus far as a strategy to extend old-age social security coverage. The importance and feasibility of universal non-contributory pensions will likely differ for urban and rural parts of low-income countries. Because employment formality and administrative capacity are likely to be higher in urban areas than in rural areas, means-tested non-contributory pensions may hold more potential for urban areas. Nevertheless, the political, economic, and social benefits of universal non-contributory pensions are substantial and relevant to both urban and rural communities.

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