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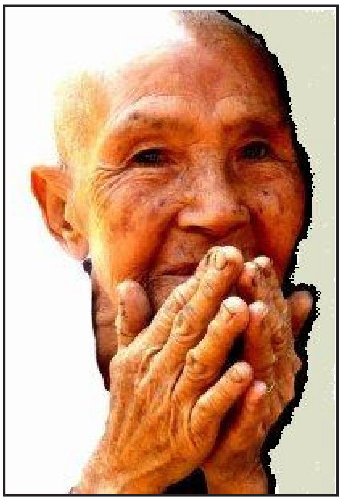
SOCIAL SECURITY: A DEMOGRAPHIC IMPERATIVE



ASIAN INSTITUTE OF TRANSPORT DEVELOPMENT

Contents

Social Security: A Demographic Imperative

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ASIAN INSTITUTE OF TRANSPORT DEVELOPMENT

The Institute is an independent, not-for-profit organisation devoted to non-partisan research, education and training in the area of infrastructure with special focus on transport sector. Its principal purpose is to promote balanced, equitable and sustainable development for enhancing overall welfare of the community.

The Institute has been granted special consultative status with United Nations Economic and Social Council. It also has a collaborative agreement with UNESCAP for undertaking joint activities. The Institute's membership from south and south-east Asian countries facilitates its well-defined mandate of promoting regional cooperation.

The Institute provides substantive support to various regional initiatives – BIMSTEC, SAARC, Mekong-Ganga Cooperation, etc. It promotes human resource development by organizing training courses for the personnel from the member countries of these groupings.

It also fosters research in universities by awarding scholarships to students pursuing M.Phil, Doctoral or post-Doctoral research. This programme is in the process of expansion with a long-term support of adequate corpus.

SOCIAL SECURITY: A DEMOGRAPHIC IMPERATIVE

Foreword

It was in 1998 that AITD had focused attention on the escalating pension liabilities of Indian Railways through its publication 'Greying of Indian Railways'. It was a pioneering study and was mainly instrumental in making the government sit up and take note of the increasing burden that a growing population of retired employees will cast on its finances in the years ahead.

Subsequently, the Institute also brought out two more publications that highlighted the problem of old-age security: a monograph titled 'The World of Pensions', and a special issue of the 'Asian Journal' dealing with pension reforms. The present monograph goes beyond pensions and provides an overview of all types of social protection measures that have been introduced for the aged in different countries.

Each country has to structure its social security programmes taking into account the state of its ageing population, and the fiscal capacity of its government to provide succour. It must, however, be recognized that GDP growth by itself cannot solve the problem of social security. Equally necessary is the development of social structures to help households in managing future income shocks that will inevitably arise on account of ageing populations.

It is a matter of great satisfaction that the Institute's pioneering studies have contributed in no small measure to the initiatives taken by the Government to deal with the problem of unfunded pension liabilities and social problem of dealing with greying of populations, particularly the poor amongst them.

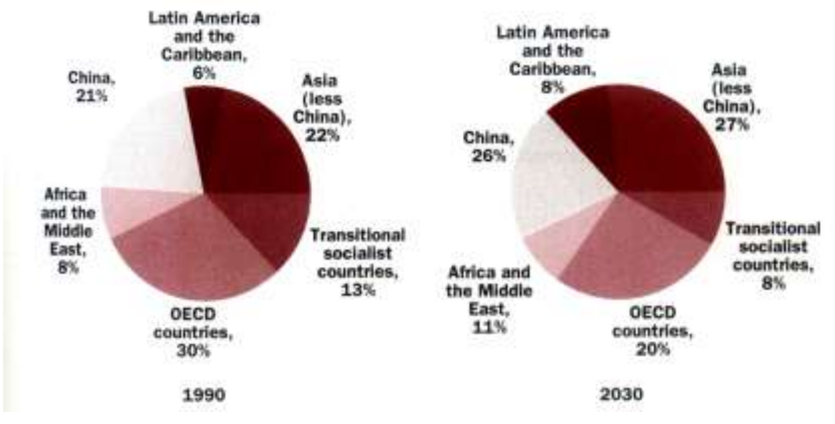
K. L. Thapar
Chairman

Chapter 1

Background

In the Middle Ages, in Europe, life expectancy at birth was close to 28 years. It is only in the last 100 years that, on account of advances in medical technology and improved sanitation, life expectancy has increased dramatically. At the same time, there has been a significant fall in fertility rates which would reduce the rate of replacement of those who die, implying that there would be a larger number of aged who will require support for a period longer than before. It is estimated by the World Bank that the proportion of world's population that is more than 60 years old would rise from 9.5 percent in 1990 to 16 percent in 2030, and by then more than three-quarters of the world's old people will be in areas which are not industrial today, more than half being in Asia alone (Figure 1).

Figure 1: Percentage of the People over 60 years old, by region, 1990 and 2030



Note: Japan is included with the OECD countries, not with Asia.
Source: 'Averting the Old Age Crisis' (World bank, 1994).

In their latest report, the United Nations Population Fund has warned that the world population is likely to go up from

6.7 billion today to 9.2 billion in 2050. At present, in developed countries, 20 percent of the population is already over 60 years old, and this proportion is projected to reach 33 percent in 2050. Most countries in Asia and Latin America, which today have more working age adults than children or elderly, will also soon start to age, and will be heading in the same direction as Europe and North America.

As individuals grow old, their capacity for work diminishes, forcing them to seek other means of support. Moreover, with societies moving away from the traditional joint-family structure to more modern nuclear families, and children moving away to urban areas for their living, the elderly are often left financially unprotected.

Added to the above, is the myopic behaviour of individuals with regard to saving for old age. A large proportion of adults find it difficult to accept that they need to plan for a long period of old age during which they will be unable to generate sufficient income. Hence, they are unable to make a realistic assessment of the crucial economic aspects of their old age, such as the labour income they will earn, the medical costs they will have to bear, and the length of the time of their retirement.

A majority of the informal sector workers are too engrossed in their problems of immediate survival to have any motivation to provide for a distant eventuality like old age. Additionally, income security in old age may not be the primary concern of poorer households; disability and sudden illness figure more prominently in the profile of risks faced by them. Because of their relatively higher mortality rate, they may also not be able to enjoy their social security benefits for a long time. Hence, they have the inclination to consume today rather than save something for tomorrow.

An alternative source of old age support is the savings that an individual generates during his years of working, mostly compulsorily as a deduction from his salary, and to a lesser degree, voluntarily. This safety net is also imperfect in that the lifetime poor are unlikely to have savings or to have participated in enough formal sector labour activities to have employment-related old age support.

The inability of such workers to draw on saved funds in times of hardship may place unacceptable liquidity constraints on them. This is especially true of farmers and rural non-farm self-employed whose wealth is held in illiquid forms or whose income is largely seasonal.

As the percentage of world's elderly in developing countries increases, the risk of poverty increases as well. The concurrent impact of modernization, with its weakening of family bonds, combined with the increased number of elderly suggests an urgent need to address the issue of old age security in these countries.

The primary objective of social security is to protect the poor and the vulnerable and to ensure that they have an acceptable standard of living. Social security policies are designed to help individuals and families deal with the uncertainties of economic life. Social security may also entail smoothing consumption and reducing risk or spreading income over the life cycle. Some authors claim that within the context of a developmental anti-poverty strategy social security could also include policies covering access to productive assets, employment guarantee, minimum wages, and food security. Many international organizations, including the ILO, use the broader concept of 'social protection', which covers not only social security but also non-statutory schemes.

A study on social security by the ILO describes three stages in its modern evolution. According to this study, the initial stage was paternalistic in approach: private charity and poor relief were provided for the indigent, but harsh conditions and the stigma attached made this form of provision politically unacceptable. As a reaction, in the second phase, social insurance schemes were developed based on compulsory premium that entitled the participants to pensions and payments to cover illnesses and other contingencies. In the third stage, the concepts of prevention and universality were introduced with the aim of maintaining and enhancing the quality of life.

In developed countries, social security grew significantly after World War II, and in the past thirty years many countries have introduced reforms in the area of providing unemployment benefits and social assistance. In developing countries also, new institutional structures for the care and support of the elderly are being devised. These systems are, however, mostly limited to workers in the formal or organised sectors. Thus, only a small proportion of workers that belongs to the regulated formal sectors is benefiting from a mandated minimum wage and is covered by social security. In fact, at the beginning of the 21st century, less than 15 percent of the world's 6 billion people had access to a formal system of retirement income support.

"One of the key current global problems facing social security is the fact that more than half of the world's population (workers and their dependents) are excluded from any type of statutory social protection. They are covered neither by a contribution-based social insurance scheme nor by tax-financed social assistance…The challenge for the developing countries is to design social protection schemes for the informal sector that are effective in protecting against poverty, and that at the same time promote productivity and employment."(Wouter van Ginneken).

Workers belonging to the informal sector have little or no security of employment or income. Their earnings tend to be very low. A brief period of incapacity can leave the worker and his family without enough income to live on. The sickness of a family member can result in unanticipated expenditure which may destroy the delicate balance of the household budget. Work in the informal sector is often of a hazardous nature, and the fact that it takes place in an unregulated environment makes it still more so. Globalization too, has exposed large sections of workers in developing countries to greater income insecurity as a result of greater openness and higher price risk in the world market.

The government has basically two instruments to implement its social security policy. Firstly, it can use the budget for collecting taxes that can be spent for protecting the more vulnerable sections of the society, including the elderly. Secondly, it can set up mechanisms to provide protection for certain specified groups.

Most nations fight poverty among the old by combining two income maintenance strategies: social insurance and social assistance. Social insurance denotes publicly provided or mandated contributory programmes that cover workers and their families against unemployment, health risks and old age. Social assistance refers to non-contributory transfer programmes that are means tested and targeted to the poorer sections of the society.

Chapter 2

Social Insurance

A government-sponsored social insurance programme has the following four characteristics:

- The benefits, eligibility requirements and other aspects of the programme are defined by statute;
- Explicit provision is made to account for the income and expenses (often through a trust fund);
- It is funded by taxes or premiums paid by or on behalf of participants; and
- It serves a defined population, and either the participation in the programme is compulsory or the programme is so highly subsidized that most eligible individuals choose to participate.

Social insurance should not be likened to a standard private insurance where each participant pays a premium that is based on actuarial calculation. It is to be taken as just one form of social security that is financed through taxes levied on people irrespective of their exposure to the risks that are covered. The first compulsory national insurance programmes were initiated in Germany under Bismarck: health insurance in 1883, workers' compensation in 1884, and old age disability pensions in 1889. Other European countries followed suit. After 1920, social insurance was rapidly adopted throughout Europe. In the U.S., the Social Security Act was passed in 1935. Social insurance is usually self-financing, with contributions being placed in specific funds meant for this purpose. Social insurance contributions are normally compulsory, often by both the employer and the worker.

Social insurance programmes are designed to provide income replacement and some modicum of benefit to all participants. A large number of developing countries have confined their social insurance schemes only to the formal sector. This often results in the exclusion of the self-employed, domestic employees and casual workers. Besides, in the case of many schemes it becomes difficult to cope with the volume of administrative work associated with the maintenance of accurate lifetime records for those who are insured.

Pensions

In most traditional societies, families or communities usually care only for those who reach old age, become disabled, or suffer the death of a wage earner in the family. However, as societies modernize and people move from the communities in which they have been raised, community and family ties weaken and leave the elderly and disabled without an adequate safety net. Individuals may try to save, but, in the absence of secure financial markets, savings often take the form of real estate, livestock, or jewelry, all of which may suffer from potential mishaps like disease, theft, or war. For these reasons, the government often makes some type of pension system available.

Pension systems are designed to provide an income to those individuals who suffer a loss in earning capacity because of advanced age, disability, or the death of a wage earner in the family. While, in some cases, the systems are designed to facilitate direct transfers from the government to particular target groups, in most cases, the emphasis is on providing a mechanism whereby the individual might insure himself against the loss of future earnings.

Even in developed countries, in which reasonably secure financial markets exist, governments frequently either support pension schemes directly or mandate participation in pension plans furnished by employers or private pension providers. Two reasons are commonly cited for need for government involvement in old-age pension systems. First, workers may suffer from ‘myopia’ and not think about old age when they are young and healthy. By the time they begin to worry about old age, it may be too late for them to take adequate steps to provide for themselves. Second, workers may incur 'moral hazard' by consuming as much as possible when young, with the expectation that society will care for them when they are old. The only way governments can limit the cost of caring for the elderly is to make participation in a pension plan mandatory for those individuals who can afford it and then limit direct government transfers only to those people who are too poor to be able to save during their working years.

Objectives of Pension System

There are two main objectives of a pension system: to reduce poverty among the elderly, and to smooth consumption between the working years and the retirement years, such that an individual does not suffer a huge drop in his living standard when old age or disability reduces his earning ability. While the first objective, that of poverty reduction, may be financed through general revenues, consumption smoothing is typically financed by contributions from workers. Usually, workers make contributions based on their incomes and expect to receive pensions that are also based on their incomes. However, the financing of pension systems through workers' contributions that are based on their wages introduces a new set of problems. It becomes close to impossible to collect and record contributions from workers who are not part of the formal sector

The pension framework has two mandatory tiers: a redistributive part (where the income gets redistributed to the poorer workers) and an insurance part. Redistributive components of pension systems are designed to ensure that pensioners achieve some absolute, minimum standard of living. Insurance components are designed to achieve a target standard of living during the period of retirement that is based on the standard of pre-retirement years.

Among the redistributive schemes, the most common are the basic pension schemes, where the benefit is either flat rate or the amount is determined by the number of working years. The other type comprises the targeted schemes where higher benefits are paid to the poorer pensioners and reduced benefits to the better-off retirees.

Insurance components are designed to achieve a target standard of living after retirement that is based on the standard of pre-retirement years. They are aimed at ensuring that retired people have an adequate replacement rate (retirement income relative to earnings before retirement) and not just a poverty-preventing absolute standard of living.

For structuring the public-pooled component of a government-organised retirement security system *with a poverty prevention objective*, there are at least three alternatives. These are: (i) a minimum pension guarantee, or benefit top-up to workers who have contributed for a specified number of years to a retirement security regime; (ii) a benefit targeted to the elderly poor; and (iii) a universal flat pension, sometimes called a 'demogrant', paid to all men and women over and above some threshold age, regardless of their means. A minimum pension top-up covers workers with low life-time earnings who contribute to the retirement security system, but leaves workers without a history of payroll contributions uncovered. A targeted pension provides benefits to only those elderly whose income or accumulated wealth is below some specified level. A universal pension covers all individuals of a certain age regardless of their income, accumulated wealth or contributions history. In several countries, these alternative poverty prevention pension structures overlap.

Some countries, such as Australia, New Zealand, and, to a lesser degree, the United States, focus on poverty reduction more than consumption smoothing. New Zealand offers a flat pension, unrelated to previous income, to all individuals of a certain age, while Australia offers a means-tested pension that provides some level of benefit to more than 75 percent of the elderly. But, even within contributory schemes, such as the one obtaining in the United States, a progressive benefit formula can result in a greater focus on poverty reduction relative to consumption smoothing. While the average pension paid is around 40 percent of the relevant wages, high-income individuals receive as little as 20 percent of their wage level in the United States, while the low-income individuals receive 100 percent of their previous wage. By contrast, countries such as Austria and Sweden strongly link contributions and benefits and achieve much higher rates of consumption smoothing.

However, some countries choose to distinguish between these objectives by pursuing them through separate instruments. Social assistance programmes, either part of overall programmes or programmes especially targeted to the elderly, may account for the bulk of poverty reduction, while the contributory system focuses on consumption smoothing. The French and German systems would fall in this category, wherein the pension system itself is not expected to redistribute toward the poor, and old-age poverty relief is provided by other instruments.

Given the possibility that more than one instrument may be used for old-age support, the pension system should not be viewed in isolation. This system may be merely one of the many elements comprising the social safety net for the elderly. Each individual element need not incorporate the same level of redistribution since the pension system's objectives extend beyond redistribution.

Defined-Benefit Plan

Most formal public pension systems currently pay *defined benefits (DB)* according to a formula based on the worker's earnings and years of service, and are financed by payroll taxes on a pay-as-you-go (PAYG) basis, meaning that the contributions made by the existing workers are used to pay the pensions of those who have already retired. However, it is now widely recognised that these systems generate many problems that include:

- misallocation of public resources, as scarce tax revenues are used for pensions rather than for education, health, or infrastructure;
- lost opportunity to increase long - term savings;
- unintended inter-generational transfers (often to high income groups); and the growth of a large hidden implicit public pension debt, which makes the current system financially unbalanced.

Besides, in a PAYG programme there is no link between the contributions made to the retirement system and the benefits one receives from it. The contributions are defined by one law which lays down payment of the payroll tax, while a separate law defines the benefits, and these laws may change over the period of 40/45 years that each worker spends in the labour force. Individuals also try to minimize what they contribute to the system (e.g. through under- declared income, evasion) and maximize what they get out of it (e.g. through early retirement), and the end-result is a growing deficit. The PAYG system also enables politicians to please current workers with promises of benefits that will be paid by future workers through higher payroll taxes.

Public contributory programmes in most developing countries cover civil servants and in a majority of cases also cover workers in public enterprises. In many countries, the provision of old age, disability and death benefits for *civil servants* pre-dates the establishment of national security schemes for private sector workers. Historically, these benefits were granted as a form of reward for long service. Lifetime employment had been the norm in the civil service, and the prospect of receiving an adequate pension on retirement has traditionally been viewed as an inherent attraction of employment in the public sector.

In industrialized countries, most retirement schemes for civil servants continued as separate schemes even after the introduction of broad-based national insurance systems. In the case of low-income economies, many of the civil service pension schemes originated with the colonial administration, and to this day, civil servants are practically the only category of workers with retirement income coverage. Since World War II, the maintenance of separate schemes for public service employees has been increasingly criticized, particularly in countries where there is a high proportion of civil servants in the workforce.

A large number of developed countries have come to realize that defined-benefit systems in their present form are not financially sustainable. Ageing populations and increasing longevity have increased the ratio of retirees to employed persons which compounds the problem further. These trends have also put enormous pressure on the financial solvency of the defined-benefit systems around the world. Since World War II, pension expenditures (as a percentage of GDP) have risen sharply, the rise being more pronounced in the industrial countries. Attempts to introduce reforms have met with stiff resistance from the employees. Sample the following:

"On May 13, thousands of French workers took to the streets to resist Prime Minister Jean-Pierre Raffarin's proposed pension reforms…..Top on the list is a 2008 target to match the private sector level of 40 years of work for a full pension. Currently, government workers must toil only for 37.5 years…….Like most of the euro zone, France faces a demographic time bomb. The government says the current pay-as-you-go pension system had two workers subsidizing every retiree in 2000. By 2020, the ratio will be 1 to 1." (*Business Week/ May 26, 2003*).

"On May 6, the country was brought to a halt by a rare country-wide strike. The strike stymied public transport and closed schools and dozens of the country's biggest companies, in protest against the government's plans to overhaul Austria's pension system. Most Austrians feel edgy about the government's pension proposals, which would reduce pensions under the current pay-as-you-go system for future retirees by a good 10 percent (and by 30 percent in some cases)" (*The Economist / May 10, 2003*).

Financial stresses are also being faced by civil service pension schemes around the world. Most countries underwent periods of massive expansion of public employment in the seventies and eighties, followed immediately by periods of contraction, leading to a dramatic rise in the ratio of pensioners to covered employees and resulting in a steep rise in pension expenditure. Many countries have taken steps to reduce their civil service pension liabilities by introducing higher retirement ages, increasing employee contribution rates or gradually shifting towards some form of advance funding of benefit obligations.

Defined-Contribution Scheme

The second most common form of pension-insurance provision is the *defined-contribution (DC)* plan. In such a scheme, each worker has an individual account in which contributions are saved and invested, and the invested capital is converted into a pension-income stream at retirement, typically, an annuity. The formula specifies the amount of money that must be contributed to the plan, but does not specify benefit payouts. Contribution rules are usually a predetermined fraction of the salary although that fraction need not be constant over the employee's career.

In a DC plan, the participating employee has often some choice over both the level of contributions and the way these sums are invested. The employee bears all the investment risk. The retirement account is, by definition, fully funded by the contributions, and the employer has no legal obligation beyond making its periodic contributions. Hence, the task of setting and achieving retirement income replacement goals falls on the employee. While such schemes are more transparent so far as linkage between contributions and earnings is concerned, they fail to provide protection against shocks to longevity, earnings and inflation. Hence, pure defined-contribution systems that are not accompanied by a safety net, such as a minimum - pension guarantee, to protect workers against excessive fluctuations in the capital markets, do not prevent the elderly from falling into the poverty net.

Defined Benefit vs Defined Contribution

Employers have taken advantage of the switch from DB to DC to cut the level of their payments drastically. That is hardly surprising: the cost of meeting the DB promise was what prompted employers to switch to DC schemes in the first place. Figures from Britain show that the average level of employers' payments into DB schemes, as of October 2007, was 14.2 percent of payrolls; in DC schemes, by contrast, the average was just 5.8 percent. Employees are not making up the difference. They are pumping just 3 percent of their salaries into British DC schemes, taking the total of 8.8 percent, against the equivalent of DB schemes of 19.1 percent. In America, total DC contributions at the last estimate were slightly higher than in Britain, but were still only 9.8 percent.

Lower contributions almost inevitably mean lower pensions. Watson Wyatt estimates that the median 25-year old contributing at the British DC rate would earn a pension of about 30 percent of his final salary. And that assumes an optimistic rate for annual costs of 0.3 percent, whereas many DC schemes have expense ratios of more than 1 percent. In DB schemes, contributing for 40 years would entitle the employee to 66 percent of the final salary.

The loss to DC scheme members is partly offset by their own lower contributions – in other words, higher net pay – of around 2 percent a year. But DC members also have investment risk; for about 5 percent of them, the pension would be worth just 15 percent of their final salary.

(The Economist – June 12, 2008)

Notional Defined-Contribution Plan

Combining the features of both DC and DB schemes is the *notional defined-contribution* scheme – as introduced in Italy, Sweden, Latvia and Poland – where both the contributions and the interest earned on them exist only in the books of the managing institution. At retirement, the accumulated notional capital in each account is converted into a stream of pension payments using a formula based on life expectancy at the time of retirement.

Each country places a different emphasis on redistribution or pension adequacy, and insurance or pension-replacement rates. According to a recent study by the World Bank, the English - speaking countries tend to emphasise the aspect of pension adequacy by adopting pension systems that have a weak or no link between pension entitlements and pre-retirement earnings. Examples are Australia, United Kingdom, Canada and, to a lesser degree, the United States. On the other hand, in the Middle-East and North Africa, emphasis is on providing the same or very similar replacement rates to all workers, so that there is a strong link between pensions and earnings. Coverage under contributory programmes in different countries has been indicated in Tables 1 to 6 in Appendix I. It would be seen that the extent of coverage in different regions has a strong correlation with their level of economic development.

A recent study reveals that reforms in social security provisions and changes in the benefit level can have strong fiscal effects for the government. For instance, a simulation analysis of 12 countries brings out that a three-year increase in eligibility ages would reduce government benefit payments, minus tax revenues, by 27 percent of current programme cost.

National Provident Fund

As the British were dismantling their empire in the 1950s, they generally left behind a pension legacy consisting of two elements. One was a conventional defined benefit pension scheme for government workers, basically budget–supported. The other was the National Provident Fund (NPF) for those in the industrial and urban formal sector. It had become increasingly obvious that social welfare and social development issues had been seriously neglected in pre-war colonial policy. Accordingly, the immediate problem was one of providing, within the existing tight budgetary constraints, at least minimal standards of welfare provision, particularly on retirement, for workers facing an increasingly uncertain future.

Provident funds focus exclusively on retirement and do not include other benefits. They operate as compulsory individual savings accounts, with beneficiaries entitled to a lump-sum at retirement. Several provident funds have been transformed into social security arrangements with pensions organized on the basis of a defined-benefit principle.

ILO's antipathy to this form of social security is, however, well known and is documented in its Social Security (Minimum Standards) Convention no. 102 of 1952. This hostility rested mainly on the fundamental inconsistency between a lump-sum payment and the central requirement of pension insurance, namely, to ensure that the benefits specified should be granted throughout the period of retirement.

ILO's skepticism about this model of retirement provision has been proved correct to a large extent by the manner in which such schemes have been operated in some developing countries. Continuing administrative weaknesses and widespread political manipulation and corruption have characterised these schemes, and inflationary conditions in the economy have compounded their inefficiencies.

Investment restrictions which lead to an excessive accumulation of government instruments also serve as a disincentive to the development of a balanced capital market. Another controversial issue is the government's decision to pay a specifiied rate of return in any given year, to contributors of the provident fund, independent of the actual return on the portfolio. This has almost always been the case in both Malaysia and

Singapore where the real rate of interest gained by PF investments is higher than what is credited to the members' accounts. This differential is tantamount to an implicit tax for the beneficiaries.

The most important current development is the trend towards the introduction of pension schemes to complement the lump-sum benefit provided by NPFs especially in some of the Asian countries. For instance, in 1995, the Indian authorities reformed the Employees Family Pension Scheme (1971), which provided a limited pension for widows and young children in the event of death prior to retirement of a member of the Employees' Provident Fund.

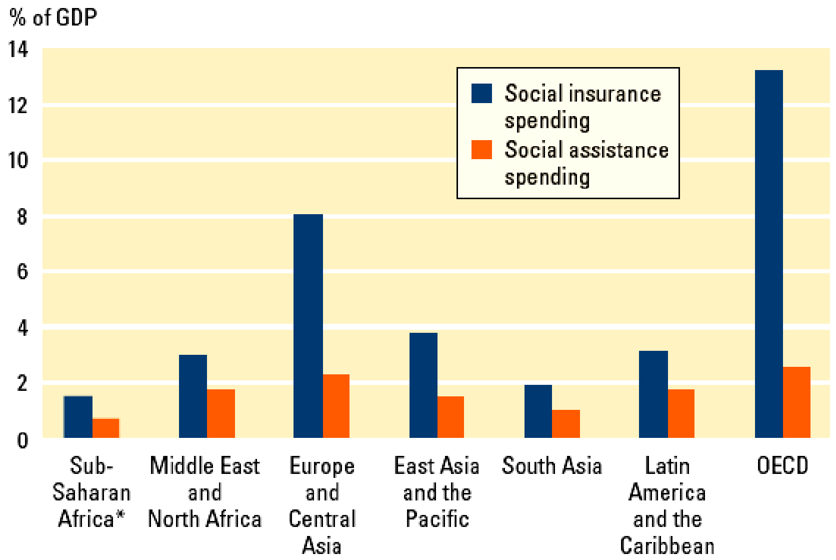
In April 1996, the Employees' Provident Fund of Nepal established a limited period pension scheme for its members. In Malaysia, where life expectancy has now attained levels approaching those found in OECD countries, there are indications that the Malaysian EPF may also introduce a pension scheme to complement current contingencies for retirement savings. Thus, the choice between social insurance-based retirement systems and provident funds should no longer continue to be seen as mutually exclusive. The types of mandatory systems for retirement income across the world are listed in Appendix II.

Chapter 3

Social Assistance

Social assistance programmes, which can also be described as social safety nets, can be defined as non-contributory public programmes targeted to the poor, with the objective of raising living standards to an acceptable social minimum. These are in contrast to social insurance programmes, such as contributory pensions or unemployment insurance that are largely related to earnings and need not include any transfers. A review by the World Bank concludes that almost all countries spend more on social insurance than social assistance programmes (Figure 2).

Figure 2: Spending on Social Insurance and Social Assistance



Source: World Development Report, 2006, The World Bank

Safety Net Programmes

Common safety net programmes include:

- Means-tested cash transfers to the elderly poor
- Employment in public works

- Food- related programmes
- Price and other subsidies
- Health care services
- Provision of education, electricity and housing

Means-tested Cash Transfers

The advantage of *means-testing* of the social pensions is the improved targeting of the fiscal expenditure directly toward poverty relief. The main impediment to implementing this type of programme is the cost of service delivery, especially in countries where means-testing involves significant overhead costs. Moreover, assessing those who need assistance can be difficult, especially in rural areas. The experience of several countries with means-tested programmes for the elderly has been that the political support for these programmes has been limited and funds earmarked for them tend to get diverted to other purposes.

Broad-based subsidies have also lost their appeal. According to the World Bank, they are expensive and relatively inefficient at reducing poverty. Housing and infrastructure subsidies, for example, turn out to benefit higher income households disproportionately. Food subsidies can be more effective if they are targeted toward items consumed primarily by the poor. Tunisia has effectively moved from a non-targeted to a targeted programme by eliminating all subsidies on goods consumed disproportionately by the non-poor and, for those food products still subsidized, by differentiating product lines through differences in packaging and the use of generic ingredients. These reforms reduced the cost of food subsidies from 4 percent of GDP in the mid-1980s to 2 percent by 1993, while still maintaining a food safety net for the poor.

Workfare Programmes

Workfare programmes require recipients of social assistance to work or to enrol in educational or job training programmes. Should they refuse, their entitlement to financial aid and related benefits could be reduced or withdrawn. The underlying assumption of a workfare programme is that individuals should not receive financial assistance from the state unless they are prepared to work or to participate in programmes leading to employment. Such an assumption flows from a philosophy that considers the individuals requiring financial assistance need to be brought under the discipline of stringent regulations. The intent of workfare programmes is to reduce the number of individuals receiving social assistance by bringing them in the orbit of employment.

Such programmes have, however, been shown to reach only a small proportion of the unemployed. For example, the Maharashtra Employment Guarantee scheme launched in the 1980s and widely regarded as one of the most successful and relatively larger public works schemes covered less than 20 percent of the households in the bottom income bracket.

Conditional Cash Transfer Programmes

These programmes have two components: an education component and a health/nutrition component. The education component consists of a cash grant targeted to primary school-age children. In countries with higher educational attainment, such as Mexico, Colombia and Jamaica, this component also seeks to benefit secondary school-age adolescents. The receipt of education grants is conditional on school enrolment and regular school attendance.

Health and nutrition grants consist of a cash transfer aimed at food consumption, combined with an incentive for the provision of health care for children and nutrition education for mothers. Receipt of the cash transfer is conditional on compliance by participating household members with a pre-determined number of health centre visits and participation in health and nutrition workshops. These grants are usually family-based and are targeted to newborn children up to the age of 2 or 3 years, and in some cases, up to the time they enrol in a primary school.

Advantages of Safety Net Programmes

Safety net programmes perform two key functions in economic policy. Their traditional role is to redistribute income and resources to the needy in society, helping them to overcome short-term poverty. At the national level, safety nets also contribute to the society's choice of effective policies in other areas. For example, if sound safety nets are in place, the pension programme can focus on improving the efficiency of providing benefits to contributing workers rather than finding ways to provide cash transfers to those who have not made adequate contributions.

Informal (private) safety net arrangements are also important as they help in protecting household income. They should be considered for adoption by countries which are planning to introduce formal social security programmes. Cash and food transfers between households are prevalent in many regions; labour exchange is common in sub-Saharan Africa; and *zakat* – giving in charity, expected of every able Muslim adult – is customary in many Islamic countries.

In the past few decades, as a result of escalating budget deficits and increasing calls for enhanced public sector fiscal responsibility, governments have been examining and introducing measures aimed at delivering more cost-effective services. One of the more publicly conspicuous targets of these expenditure reduction efforts has been in the realm of social assistance and income support. However, it has become increasingly clear to the policy-makers that simple reductions in the social assistance entitlements or introduction of more stringent eligibility criteria would not be sufficient. More innovative approaches to reduce the growing number of individuals receiving social assistance benefits would also be necessary.

In the long run, a reformed system aimed at reducing continued dependence on income support programmes, and improving self-sufficiency among social assistance recipients, would reduce future needs and enhance long-term economies to the income support programmes. For instance, in Canada, in the late 1980s and early 1990s, federal, provincial, and territorial ministers responsible for social assistance and labour market affairs came to an agreement for integrating social assistance recipients into the workforce. This agreement allocated funds for the development of new or expanded training and work experience opportunities for social assistance recipients and increased financial incentives for training and/or work opportunities.

Non-contributory or Social Pensions

The role of contributory pension model is pervasive in most of the developed countries and many developing countries too. However, reliance on this approach is now being seriously questioned in the developing countries. The reason is the failure of these countries to extend the mandate to a large part of their population. The workers that do participate in these programmes tend to belong to the upper half of the income distribution, mostly urban residents or having a secure career with the public sector. International organizations like the World Bank and ILO are, therefore, focusing on non-contributory or social pensions as a way to improve the coverage in an ageing world.

Some social pensions act as a *supplement* to the existing contributory schemes that have widespread coverage, as is the case in the United States, France and Germany. In other countries with no mandated contributory systems, social pensions are the core element to be paid out to most of the elderly. Most of the developing countries have, however, still not determined the role of social pensions. Almost all of them have a contributory scheme, but the coverage of such schemes is typically limited.

Large-scale non-contributory pension programmes for the older people have been established in very few developing countries. Brazil and South Africa have two of the largest such programmes and Bangladesh provides an example of a newly established programme in low-income countries. Over time, these programmes have come to be recognized as institutions for reduction of poverty and inequality in these countries.

South Africa: A social pension (640 rand in 2002) is paid to men aged 65 and over and women aged 60 and over. The programme was funded through general taxation absorbing 60 percent of social security expenditure, and 1.4 percent of GDP in 2002.It is widely acknowledged that the old-age pension has a significant impact on poverty alleviation among Africans and that it brings about a substantial redistribution of income in the country.

Brazil: The 1988 Constitution of Brazil incorporated the right to social protection for all, including workers in the rural sector and in informal employment. In 1991, as part of the reforms, a new rural old-age pension (PR) was established; age of pension eligibility for men was 60 years and that for women 55 years. Entitlement was conditional on workers engaged in agricultural or subsistence production, and not having contributed to social insurance. The value of the pension benefits was raised from 0.5 to 1 minimum wage (200 Reais in 2002).

In urban areas, provision of old age assistance is much less developed. A social assistance pension (RMV) was introduced in 1974 paying a flat rate benefit of one - half of the minimum wage to older or disabled people who could not provide for themselves. To be entitled to the RMV, individuals needed to be 70 years of age or over and have at least 12 months of contributions to social insurance. A new social assistance pension (BPC) was introduced in 1996 paying one minimum wage to the disabled or elderly people aged 67 and over living in urban or rural areas with per capita household income no greater than a quarter of a minimum wage. Excluding disability pensions, the cost of providing old age non-contributory pensions in Brazil is around 1 percent of GDP.

***Bangladesh**:* Here two sets of social welfare programmes exist. First is the Old Age Allowance Scheme (OAAS) under which a monthly allowance of around Taka 130 is paid to the 10 oldest and poorest members (5 men and 5 women) of each ward of the union, the lowest level district. The second is the Assistance Programme for Widowed and Destitute Women (APWDW) which adds further 5 beneficiaries per ward. The programmes are financed from general government revenues, through budget allocations in the five-year plan. The total cost of the two programmes is around 0.3 percent of GDP. Though the programmes are reasonably well-targeted their coverage is not sufficient and they have not been able to pull beneficiaries above the poverty level.

The adoption of non-contributory pension programmes in the above countries arises from the failure of social insurance or occupational pension plans to extend beyond workers in the formal, especially public, employment. They are explicitly anti-poverty cash transfer programmes based on age. They follow a different logic than that ingrained in the formal programmes supporting older people: they are not determined by labour market factors and do not encourage retirement from the labour force.

The available evidence from a number of studies suggests that non-contributory pension programmes reduce poverty among older people and their households, insure poorer rural communities against the adverse effects of agricultural reform, and encourage local economy activity. Palacios and Sluchynsky have developed a social pension impact index for selected countries which is placed at Appendix III. It shows that the impact on poverty rates is the highest in those countries where social pensions form the core scheme for providing social benefits, i.e., where there is either no mandated coverage for private sector or there is low coverage in the contributory scheme. In another study, Barrientos finds a drop in poverty rates from 61 to 54 percent in households receiving social pensions.

Aside from the poverty impact there have been other indirect impacts also. In Brazil, there was an observed increase in the number of children living with pension-recipient grandparents, especially in the rural areas. Migration of working-aged adults from rural areas has also increased in certain cases. A study in South Africa finds that the elderly who received a pension had a higher health status than those who did not receive a pension, holding other factors like age and gender constant.

Introducing a new social pension programme or expanding an existing one would require additional borrowing, taxes or cuts in other spending. It has to be ensured that the marginal benefits of the programme are higher than the marginal costs involved, for there could be other programmes that might generate equivalent or greater reduction in poverty: through better education or health, for example.

Universal Pensions

A number of countries, both developed and developing, offer *universal pensions* to all residents above a certain age regardless of their income. This may appear to be the best way to reduce old age poverty, since all the elderly, irrespective of the number of years they worked or the amounts they contributed for pension are eligible to receive some benefit. Considering the difficulty of identifying who among the elderly is poor, the principal merit of the programme is that its universality avoids the targeting issue.

However, in such a system many people who would be receiving it will not be poor. As a result, in terms of poverty reduction achieved per unit of currency spent, the expenditure may not be wholly effective. Moreover, in countries where such programmes have been adopted (Namibia, Mauritius), despite a mandate for universal pension, many rural elderly have not been receiving the pension. The reasons ranged from lack of access to the pension distribution network and difficulties with verifying age and eligibility to different types of fraud.

Nevertheless, attempts are being made, with assistance from ILO, to improve the system of disbursement of pensions to the rural poor. In Namibia, for instance, a public-private partnership helps to pay pensions and other social security benefits throughout the country. There, a private company – under contract with the Ministry of Health and Social Services – employs 13 crews running across the whole country in pick-up trucks to pay the state old-age pensions, child maintenance grants and disability pensions to all eligible residents of rural areas. The trucks carry an ATM hooked up to a laptop computer, a fingerprint and smart- card reader, and a simple digital camera. The laptop contains the bio-data, identification data and benefit amounts of all beneficiaries. The beneficiaries bring their smart-cards; the reader checks the identity of the fingerprint, notes the payment on the smart card and dispenses the money.

ILO estimates that in some countries of Africa, such basic social cash transfers could directly reduce extreme poverty rates by 35-40 percent.

Social Funds

Social funds provide financing (usually grants) for small-scale public investments targeted at meeting the needs of the poor and vulnerable communities, as well as at contributing to social capital and development at the local level. They serve as demonstrators of new methods of decentralized participatory decision-making, management, and accountability.

The first generation social funds, launched in the 1980s, were created to serve as short-term safety nets to soften the impact of structural adjustment policies on the poor. Originally, the programmes were meant to provide quick employment through public works projects and emergency social services, and sometimes designed explicitly to compensate for layoffs caused by downsizing of the public sector entities. These programmes have since been used in more than 60 countries for purposes ranging from post-emergency reconstruction to empowerment of local communities.

Second generation social funds have adopted more explicit institutional strategies aimed at capacity building and achieving sustainability goals with a focus on longer-term objectives. They have played an important role in funding community projects, empowering communities and building linkages between communities and their local governments.

Social funds have financed many activities, such as opening of schools, medical centres and provision of drinking water that needed sustained support from line ministries or other agencies of the government, once such projects were completed. However, in several cases, no operating funds were forthcoming for staff and maintenance, particularly in the case of schools and health services. Poor communities are handicapped in taking over the responsibility for operation and maintenance themselves mainly because of their lack of organizational capability and minimal linkages to official networks.

The principal advantages of social funds are:

– They aim to improve allocative efficiency by delivering public goods and services in a way that fits local preferences better than centrally-controlled and implemented programmes and also reduce corruption.

– Since these funds allow communities to handle the procurement and financing of their subproject, there is more effective supervision, accountability, local capacity building, and production efficiency.

Chapter 4

Social Security Schemes around the World

According to a survey report by the US Social Security Administration, there are 167 countries which currently provide some form of social security benefit to meet the contingencies associated with old age. Efforts being made by selected countries, situated in diverse geographical regions and at different stages of economic development, to restructure their social security systems are described below. Their individual policies and programmes may vary, but the objective remains the same, i.e. to make their systems more welfare-oriented and to ensure a larger coverage.

Latin America

Benefits under the old, publicly managed, defined-benefit, PAYG systems were disproportionately generous relative to contributions. Most countries in the region, therefore, jettisoned a significant part of their public social security systems in favour of privately managed, and individual account based, defined-contribution funded systems which are often mandatory. Examples are Peru, Argentina, Colombia, Uruguay, Mexico, Bolivia and El Salvador.

Chile took the first step to establish a direct link between contribution rates and benefits and thereby link the savings efforts with the reward during retirement. The privatized scheme in Chile is mandatory for all new employees, but optional for the self-employed. Instead of paying a social security tax to the state, each worker contributes 10 percent of his wage into one of the privately managed approved funds. After contributing for 20 years or more, the worker uses the accumulated assets to purchase an annuity. If the resulting annuity falls below the level of minimum pension, the worker is awarded a minimum pension. Chile's minimum pension is 25 percent of the national average wage and is indexed to inflation. Minimum years of contribution required for receiving pension in other Latin American countries are different than those in Chile; so also is the quantum of minimum pension.

The private pension systems have a limited coverage and are mostly accessible only to formal sector workers. Despite the positive impact of the pension reforms on workers' incentive to seek coverage, the share of workers who contribute to the formal retirement security systems, is still low relative to OECD countries. The most dramatic change in labour force participation in the retirement security system has been in Chile where after the introduction of mandatory individual retirement accounts in 1981 the share of contributors to the retirement security system has been rising steadily.

The individual retirement savings accounts tend to be popular among the middle and upper-income workers, primarily because the returns on contributions to these accounts in recent years have been greater than the imputed returns from the public defined-benefit schemes. However, there is much less interest in individual accounts among the low wage workers, since many of them will be having low balances in their accounts when they reach retirement age. As a result, they end up taking the guaranteed minimum pension (instituted by most governments in Latin America) and the size of the pension is not influenced by the balance in their accounts.

Most countries in Latin America offer both the contributory minimum pension guarantee and a targeted benefit to the elderly poor. Chile's minimum pension guarantee ensures that retiring affiliates with at least 20 years of contribution history to the pension system retire with a minimum annuity amount, which is initially financed out of the accumulated balance in the affiliate's individual account and then by the government directly when these savings are exhausted. This model has also been adopted in Colombia, Mexico and El Salvador. Mexico offers an additional account subsidy, which has an important poverty prevention role for the poorer affiliates. With the exception of Bolivia, no other country in Latin America offers a universal flat pension.

Coverage indicators show that more needs to be done to increase access to at least minimum levels of protection against the risks to income from old age. A large portion of affiliates may not qualify for the minimum pension guarantee of PAYG or funded systems. In Colombia, E1 Salvador, Mexico and Peru, governments do not even offer these means- tested benefits.

One way to increase coverage is to make participation mandatory for individuals who are currently excluded, such as the self-employed. However, enforcing compliance is administratively expensive and difficult. The state approach is to provide old-age income security through social pensions and social assistance to those who are not covered by the new pension systems. But universal and non-means-tested programmes are usually expensive and inefficient, and means-tested programmes are difficult to administer.

Critics feel that Latin America's new pension funds will not be able to provide the retirees with adequate savings. First, many pension funds do not yet invest in well-diversified portfolios. Second, contributors have little choice in how their retirement savings are invested and have virtually no say in how they are managed.

Chile also introduced an *Unemployment Insurance Scheme* as an added source of financial support to the aged. The Chilean unemployment insurance system has two components. The first one takes the form of self-insurance by means of individual savings accounts. A fixed percentage of workers' wages is deposited in the workers' individual accounts. These funds plus their returns can be withdrawn according to a predetermined schedule at the end of the employment relationship. In designing the current unemployment insurance scheme, Chile's ample experience in dealing with individual capitalization accounts played an important role. Chile has more than 20 years experience with such arrangements through its private capitalization pension plan.

The second component of the programme is a subsidy paid out of a *Common Fund,* built with a portion of the firm's contributions plus direct contributions from the State. This subsidy aims to provide funds to those unemployed workers who do not have enough funds saved to cover a predetermined schedule of withdrawals, given their earnings and histories of employment.

The unemployment insurance covers all enrolled workers aged over 18 years who are employed in salaried jobs in the private sector. Those below18 years of age, the self-employed, and domestic service workers are excluded from this system. Public servants are also excluded because of their low risk of becoming unemployed. Participation in unemployment insurance is compulsory for all employees who started a new job after October 2002, and voluntary for those who were already employed at that time. The obligatory nature of this system avoids the problem of faulty selection that arises when only workers with high risk of unemployment join the system.

Unemployment insurance is funded by workers, employers, and the government. Workers and employers contribute a given proportion of the worker's salary. The government contribution is a direct, predetermined amount fixed by law. Employers of permanent workers contribute 2.4 percent of the wages to the programme. Out of this, one-third of the contribution, or 0.8 percent of wages, goes to finance the *Common Fund.* The rest (1.6 percent of wages) is deposited in the workers' individual accounts.

On their part, the workers contribute 0.6 percent of their wages. Contributions from the State benefit only permanent workers. In the case of temporary workers, the employer makes a contribution of 3 percent, which is entirely deposited in the worker's individual account. There are built-in provisions to preserve the financial stability of the Common Fund. The total amount of payments in a month cannot exceed 20 percent of the value of the accumulated funds

USA

Retirees depend on three major sources of income to meet their consumption needs: social security, personal savings and employer- sponsored retirement plans. Participation in the public social security system is mandatory for all except a few workers in some state and local governments. Social security is financed through a payroll tax of 12.4 percent, split evenly between the employee and the employer, levied against the first $72.00 of worker's income and collected through pay-roll deduction from the workers' wages. The self-employed are required to pay both portions of the tax.

Social security system is intended to achieve both, poverty alleviation among the elderly as well as income maintenance objectives. It is the fundamental underpinning of most workers retirement systems but has never been considered sufficient to meet reasonable standards of income adequacy for the overwhelming majority of workers in the economy. Social security is inadequate for low-wage workers, while for workers with higher lifetime wages, social security replaces a relatively small proportion of their pre-retirement earnings. Overall, the system provides an income replacement rate of about 40 percent of average pre-retirement earnings.

Although social security was never intended to provide sufficient benefits to meet the income needs of most of the retirees, an analysis of the financing projections made by the social security administration suggests that the programme will not meet even the benefit promises implied by the current law for many future retirees. The pay-roll taxes that support social security's pay-as-you-go system will begin to fall short of outlays in 2017 and will be sufficient to finance only 74 percent of the scheduled annual benefits by 2041, when the Social Security Trust Fund is projected to be exhausted.

Back in 1950, as the baby boom was just getting started, each retiree's benefit was divided among 16 workers. As a result, taxes could be kept low. Today, that number has dropped to 3.3 workers per retiree, and by 2025, it will reach – and remain at – about two workers per retiree. Each married couple will thus have to pay, in addition to their own family's expenses, social security retirement benefits for one retiree. In order to pay promised benefits, either taxes of some kind must rise or other government services must be cut.

As millions of baby boomers (those born in post-world war period) approach retirement, the programme's annual cash surplus will shrink and subsequently disappear. Then, social security will not be able to pay full benefits from its payroll and other tax revenues. It will need to consume ever-growing amounts of general revenue dollars to meet its obligations – money that now pays for everything from environmental programmes to highway construction to defence. There is also medicare. Taken together, social security and medicare will consume an estimated 60 percent of income taxes collected by 2040. What is left would have to finance the rest of the government. Eventually, either benefits will have to be slashed or the rest of the government will have to shrink to accommodate social security.

The actuarial deficit over the next 75 years is estimated at 1.92 percent of taxable payroll. It appears that the programme is so much out of balance that correcting the situation will necessarily involve major changes.

Private pension system is essentially a supplement to the public social insurance programme. This system in US is entirely voluntary and operates generally in the context of employer-sponsored arrangements. There are essentially two types of private pension plan arrangements: single employer plans and plans which cover a number of businesses in a common industry, known as multi-employer plans. Plans can be either defined-benefit (DB) or defined-contribution (DC).

Nearly 43 percent of the labour force participates in a pension plan. There is a continuing shift in the types of pension plans being offered to workers: from DB to DC. The usual form of benefit payment in DB plans is a lifetime annuity payable at retirement, while the usual form of payment in a DC plan is a lump-sum distribution. Private pension arrangements outside the employment-based plans are almost exclusively individual arrangements, such as deferred annuity contracts offered by insurance companies, or Individual Retirement Accounts.

401 (k) plans established by employers, allow employees to make voluntary contributions, matched generally by an equal amount by the employers. These plans which are supplemental to pre-existing DB or DC plans, have enjoyed explosive growth in the past decade or so. Income-tax liability is deferred on contributions and income is taxed when the funds are withdrawn. 401 (k) plans also offer hardship withdrawals before retirement and many such plans offer loan provision also.

Pension Benefit Guarantee Corporation (PBGC) was established as an insurance programme to assure the workers that they would not lose their accumulated pension promises if they worked for a company that went bankrupt or could not support its pension programme. It is perceived as a social insurance programme through which the collective body of defined benefit plan sponsors insures against the contingency that some individual sponsors will be unable to carry on these plans.

PBGC programme's long-term viability is threatened because the current cash on hand and the expected flow of premiums is insufficient to meet the stream of future benefit obligations under the programme. It may be mentioned that as of September, 2005, PBGC showed a deficit of $ 22.8 billion. Recent termination of a number of large, severely underfunded pension plans (e.g. LTV Steel, US Airways, United Airlines, Polaroid and Kemper Insurance) has focused attention on the disturbing financial condition of the PBGC's insurance programme. Mary William Walsh wrote the following in the New York Times (January 09, 2006):

"The death knell for the traditional company pension has been tolling for some time now. Companies in ailing industries like steel, airlines and auto parts have thrown themselves into bankruptcy and turned over their ruined pension plans to the federal government. Now, with the recent announcements of pension freezes by some of the cream of corporate America - Verizon, Lockheed Martin, Motorola and, just last week, I.B.M. – the bell is tolling even louder. Even strong, stable companies with the means to operate a pension plan are facing longer worker lifespans, looming regulatory and accounting changes and, most important, heightened global competition. Some are deciding they either cannot, or will not, keep making the decades-long promises that a pension plan involves.

I.B.M. was once a standard-bearer for corporate America's compact with its workers, paying for medical expenses, country clubs and lavish Christmas parties for the children. It also rewarded long-serving employees with a guaranteed monthly stipend from retirement until death. Most of those perks have long since been scaled back at I.B.M. and elsewhere, but the pension freeze is the latest sign that today's workers are, to a much greater extent, on their own. Companies now emphasize 401(k) plans, which leave workers responsible for ensuring that they have adequate funds for retirement and expose them to the vagaries of the financial markets. "

U.K.

State pensions provided by the government constitute the first pillar of pension provision in U.K. A report in 1942 by Lord Beveridge sent out a blueprint for social security in the post-war era, which provided for the payment of universal state pension benefits at a flat rate. The level of benefits was deliberately set at a low level – sufficient only to provide a safety net – so as to encourage the provision of second and third pillars of pension provision.

Currently, there is a basic state pension with a maximum of £86.05 per week for a single person and £ 131.20 for a married couple. The amount is increased each year in line with the increase in the Retail Prices Index. It is payable from age 65 for a man and from age 60 for a woman. Employees as well as the self-employed, qualify for this pension provided they have a satisfactory record of payment of National Insurance Contributions over a working lifetime. Credits are awarded for people unable to work. Contributions are earnings-related, although the benefit is flat rate which means that the scheme has a redistributive effect, with the better-off paying more than the lower-paid.

The Social Security Act of 1975 introduced the State Earnings Related Pension Scheme (SERPS) which was in addition to the basic flat rate pension payable to all. SERPS only provides benefits for employees; the self-employed are not included. The scheme provides for contributors to accrue an earnings- related addition to their basic pension based on such of their earnings each year which fell within a band between the level of the basic pension and an amount about seven times greater. At present, the benefits are based on 20 percent of earnings within this band. The maximum SERPS benefit plus basic state pension for a single man is under 50 percent of the national average earnings.

Occupational schemes by employers are entirely voluntary. The employer is free to choose whether to set up an occupational scheme and also whether this is to replace SERPS. As a rule, company pension schemes are set up by employers and administered by trustees. An employee can opt out of the occupational scheme and take out a personal pension. The employer may or may not contribute to the personal pension.

If the old refuse to die, let them work longer

In the UK, longevity is not only increasing; the increase is accelerating. Some experts predict that half of today's 30-year olds could live to be 100.

Could life spans increase indefinitely? In their excellent report 'Apocalyptic Demography?', David Blake and John Pickles of London's Cass Business School say that we can be 90 percent confident that, by 2050, a 65-year old English or Welsh male will live between 21 and 32 years longer – a huge and uncertain range. That is why companies have closed so many defined-benefit pensions to new and, in some cases, existing members. British employers began shutting defined-benefit schemes after companies in the US, the other country where they were once prevalent. The schemes' longer survival in the UK has made the country a pioneer in limiting longevity risk, according to John Fitzpatrick, an American partner at the UK-based Pension Corporation.

Pension Corporation is one of several companies offering to manage companies' pension assets, liabilities and risks. Las month, Pension Corporation announced that it would sell insurance to defined-benefit pension plans worried that their members would live longer than expected. In February, Lucida, an insurance company, and JP Morgan launched a derivative contract to allow pension providers to hedge against an increase in life spans greater than that predicted by a longevity index.

There are good reasons for providers of defined-benefit schemes to buy themselves greater certainty. But there is something too often left out of the discussion: our failure to adjust retirement ages to how long we are likely to live. Those who survive could spend a third of their lives in retirement. Not only is this difficult to fund; it is also a waste of willing workers.

(Financial Times, London, June 16, 2008)

Personal pension schemes are available on a voluntary basis to (a) the self-employed and (b) employees who are not members of an occupational scheme. Most of the growth of the personal pension schemes has occurred due to people opting out of SERPS. Personal pensions also play an important role in financing retirement income for the self-employed and those who do not have access to an occupational pension. Nearly 11 million people – about half of employees – are members of occupational schemes, and another 4 million are saving for their retirement through personal pensions.

The state scheme as a whole, including the basic pension, remains quite inadequate. Since the state pension payments are expected to remain at around 5 percent of GDP (against an average of 10 percent in the European Union), a large number of pensioners will continue to be poor. Flat-rate basic pension is not enough for anybody to live on comfortably. Moreover, it appears increasingly uncertain that private sector will continue to do its bit.

According to the National Association of Pension Funds, almost a third of private sector final-salary schemes are now closed to new members. There are two underlying reasons for the mess the pension industry in Britain has gone into. Firstly, the life expectancy in the UK rose by five years for men and four years for women between 1980 and 2000, forcing the pension industry to support a greater number of pensioners for longer periods. Secondly, in recent years, the stock market returns have been dwindling, which has forced most of the big company-run pension funds to suspend generous schemes which guaranteed employees a fixed proportion of their final salaries on retirement.

With the reduction in all forms of mandatory pension coverage, the pensioners will have to rely increasingly on the 'third pillar' of voluntary savings. There is a risk, therefore, that more people will, through inertia or myopia, have an inadequate retirement income in future. To address this problem, the government has introduced the Pension Protection Fund (PPF). The PPF is a type of insurance scheme of which all final salary schemes have to be a member. The PPF is supposed to step in when a pension scheme gets into difficulties.

Germany

As opposed to other countries, such as the United Kingdom, which originally adopted a Beveridgian social security system that provided only a weak pension, public pensions in Germany are designed to extend the standard of living that was achieved during the working life to the period after retirement. The German pension system is, therefore, called retirement insurance rather than social security. Further, this retirement insurance system is not part of the government budget, but is a separate entity that is subsidized by the federal government.

The German public pension system features a very broad, mandatory coverage of workers. It covers all private and public sector development employees, excluding civil servants, self-employed and workers with earnings below the official minimum earnings threshold. Thus, the system covers 85 percent of the German workforce. Although occupational pensions exist in Germany, their role is small: they cover barely 5 percent of the German elderly households.

Germany has the lowest birth rate in Europe, with an average of 1.36 children per woman (well below the replacement rate of 2.1). The population decreased in 2006 as deaths outpaced births and the number of immigrants declined. According to the German Federal Statistics Office, the low birth rate and improved life expectancy at birth (76.2 years for men and 81.8 years for women) are expected to cause the population to age dramatically over the next 40 years. Government forecasts indicate that the current working-age population (aged 20-64) of 50 million persons could decline by 22-29 percent by 2050, depending on the extent of immigration. By 2050, the number of people aged 65 or older could exceed 30 percent of the total population, compared with nearly 19 percent at present.

In March 2007, German Parliament passed a law that increased the normal retirement age from 65 to 67. This change is expected to reduce the financial pressure on Germany's unfunded public pension system by keeping its ageing workforce employed longer. By 2030, Germany is projected to have just two workers to support each pensioner, compared with the support ratio of 4 to 1 in 1990. In 2005, Germany spent €236 billion (US$285 billion) on public pensions (for both the private and public sectors), or approximately 9.6 percent of gross domestic product (GDP). According to European Commission forecasts, these pension expenditures will rise to 12.3 percent of GDP by 2030 and to 13 percent of GDP by 2050.

Nearly 70 percent of the budget of the German public retirement insurance is financed by contributions that have to be paid equally by the employees and employers. The remaining 30 percent are financed by earmarked indirect taxes and a subsidy from the federal government. The proportion of the German elderly is expected to increase from 21 percent in 1995 to 36 percent in 2035. Benefits are strictly work-related, computed on a lifetime basis and adjusted according to the type of pension and the retirement age. The benefit level is generous for middle-income earnings. The net replacement rate for a worker with 45 earning points (expressed as multiples of the income position relative to average earnings in the year) was 70.5 percent in 1998.Over the last fifteen years, however, the German system has been experiencing difficulties, as costs have soared due to longer life spans and revenue has stagnated due to low fertility rates.

Before the system was reformed in 2001 and 2004, projections indicated that the payroll tax rate needed to finance German pensions would go up from the current 19.5 percent to 28 percent of payroll in 2040. This appeared to be unsustainable. Therefore, in order to stabilize the payroll contribution rates, it was decided to link annual pension indexing, in part, to changes in the ratio of pensioners to workers supporting the system, called the "sustainability factor". This will have a stabilizing impact on the pension system because it will lower pension payouts for all German retirees, as the pensioner-to-worker ratio increases over time.

The 'Reister reform' of 2001 has changed the monolithic German system of old-age provision to a genuine multi-pillar system. The most important aspect of the reform is a partial substitution of PAYG financed pension by a funded one. Starting in 2001, Germans can put away one percent of eligible pay into their own retirement accounts. This will rise in steps to four percent in 2008. Unlike earlier reforms which sought to bring down the cost of PAYG financing, the Reister reform changes the entire pension system to include private funding. The supplementary pensions are subsidized but not mandated. The objective is to offer incentives for people to take out supplementary private pension cover which, in the long run, should compensate for the future cuts in public pensions. It is, however, not quite clear as yet whether the new voluntary supplementary private pensions will be accepted by the German workers who have been used to the all-caring public system.

China

China relies on the family to provide old-age support for the vast majority of its population. A 1994 national survey showed that nation-wide 57 percent of the elderly primarily relied on their children or spouse for economic support. But now increasing number of children are moving away from their homes and find it difficult to support their parents as much as they used to do earlier. Besides, the one child policy, which prohibits most families from having more than one child, is causing a serious problem for the aged.

Many Chinese families today face what is popularly known as the '4-2-1 phenomenon'. That is, four grandparents and two parents, both from single-child families, must be supported by a single child. Already, about 14 percent of the mainland's population is over 60 – a percentage that will grow to about 25 percent by 2030, saddling China with the world's oldest population. By 2050, every ten Chinese workers in the age group of 15 to 64 will support a total of seven younger and older people – a dependency ratio of 70 percent. This is a worrying prospect in a country where per capita income is only about $1,700 a year as against the annual per capita incomes of more than $10,000 of advanced countries, which have ageing patterns similar to that of China. Someone has aptly put it that China may be getting old before it gets rich.

An Ageing Nation

China's age advantage began reversing in 1999, when it became an ageing society, which is defined as a society where more than 10 per cent of the population is over 60. The country now has 144 million seniors, about 11 per cent of the total population, according to a white paper just released by China's state council. By 2025, this number will be 280 million (almost equal to the entire population of the US), and by 2050, it will rise to 435 million, almost a third of China's population.

As one of the world's oldest nations gets older, experts here are struggling with ways to stave off the consequences — increased pension and health costs, lower productivity, and social upheaval. Radical measures are being considered, including lifting the famous 'one child only' rule. That authoritarian decision, which is often lauded by planners for bringing China's birth rate down to 1.1 per cent, has worsened China's current demographic problems by reducing the number of youth that can support the elders. Currently, the ratio of workers to retirees and children is 4:1, but will decline to 2:1 by 2040, according to official reports.

(Business World: January 15, 2007)

In the 1950s, the public pension system was established for employees in the enterprises. The enterprises were taken as the basic entity, and based on the pay-as-you-go system the cost of social security was transferred between generations. However, with the established market economy in China and with the ageing population, the problems in the existing social security system began to attract attention.

In June 1991, the State Council issued the Resolution on Reforming the Pension System for the Employees, which signified the start of the reforms in the social security system. It was decided to gradually establish the individual provident fund system by collecting funds both from the enterprises and individuals. The idea had a three-fold objective: firstly, to ease the conflict between the ageing population and the 'pay-as-you-go' system; secondly, to force the individuals to share the cost of the social security and thirdly, to relax the pressures on the enterprises.

Within the context of the above, the social security ministry and related agencies have been making endeavours to enlarge the coverage of the new system by including the employees of the private-owned firms or the farmers in some regions.

In 1997, the government adopted the three-pillar World Bank model. The broad design of this mandatory system consists of:

(i) a basic benefit – a PAYG system entitling retirees to a defined-benefit of 20 percent of the last year's average provincial/municipal/local monthly wage;

(ii) individual accounts entitling retirees to a monthly annuity equal to 1/120 of the account's notional accumulation plus an indexation factor; and

(iii) voluntary, supplementary, individual tax-advantaged accounts.

Contributions under the first pillar into the social pool are supposed to be funded by a payment of 20 percent of the payroll by the employer. For the second pillar, the employees are supposed to contribute 8 percent of the salary to their individual accounts. Collectively, these two pillars are supposed to give a wage replacement rate of 56 percent. In practice, however, the system does not exist. Loss -making and bankrupt state-owned enterprises (SOEs) are unable to contribute to the pillar 1 pool as they do not have sufficient funds for this purpose. Pillar 2 accounts have been raided by the authorities to top- up the pillar 1 social pool.

The funds in the individual accounts are nothing but the book value because the amounts booked in these accounts have been transferred to pay the cost of the social securities. The central authorities have stepped in to make periodic supplementary top-up. But even with the central government help the situation continues to deteriorate. By 2002, the shortfalls in funding had risen to $24 billion. Over time, according to official estimates, the implied pension deficit could total as much as $ 450 billion, which is close to 40 percent of China's GDP.

It is estimated that only 28.6 percent of workers in 1998 were nominally covered by pension. According to Du and Phillips (2002), the coverage among the urban workers is about 50 percent.

The coverage under the rural pension scheme was low since in China many of the rural poor are too poor to be expected to contribute towards their retirement savings. Pensions for rural farmers wee introduced in China in 1991. This scheme envisaged voluntary personal contributions supplemented by a collective subsidy. Besides, because of the low returns and corrupt officials the farmers did not find the scheme attractive and the participation was very low. The government, therefore, stopped promoting the scheme in the late 1990s. The 10th Five Year Social Security Plan (2001) essentially ignores the issue of the rural workers.

Hong Kong (SAR), now a part of China, is faced with the pressing socio-economic problem of an ageing population. Here, people over the age of 65 currently make up 12.2 percent of the total population, a rate second in Asia only to Japan. Even with the continuous inflow of young immigrants from the mainland, those over 65 years old will reach 27 percent of the population by 2033.

Hong Kong has a separate social security system from the rest of China. In 2000, it introduced the Mandatory Provident Fund (MPF) system where workers and employers both contribute 5 percent of wages into funded individual accounts. This 10 percent total, accumulated over the working lifetime of an employee is expected to equate to a replacement rate of 30-40 percent. This is the only mandatory individual account system in Asia. It does not provide a rate of return guarantee as do many of the mandatory individual account systems in Latin America, but maintains a fund to compensate the participants for losses due to illegal activities of the fund managers. Considering Hong Kong's demographic development in the next few decades, a fully funded model – and therefore one that is financially viable in the long term – was seen as the only practical option.

The principal objective of the MPF system was to provide a cost-effective system of retirement savings for workers in Hong Kong. The main guidelines in designing the MPF system were that it should be privately managed, equitable, relatively simple and transparent, and should increase the proportion of the workforce with retirement protection.

The MPF scheme which aims to relieve the SAR government of the financial burden resulting from the demographic projections, extends compulsory coverage to all workers.

MPF schemes are required to be set up under trust. An employer may choose to set up a segregated MPF scheme that provides benefits only for its own employees, or to participate in a master trust MPF scheme provided by a financial institution.

The basic rule is that all full-time and part- time employees and self-employed persons who are aged between 18 and 65 years are required to join an MPF scheme. Exemptions include:

- Domestic employees
- Self-employed hawkers
- Civil servants and school teachers who are covered by statutory pension or provident funds
- Members of occupational retirement schemes which are granted exemption certificates
- Non-Hong Kong residents who have been working in HK for less than 13 months or are covered by overseas retirement schemes
- Employees of the European Union Office of the European Commission in HK

Employees earning less than HK$5,000 per month are not required to contribute but may choose to do so, while employers must make the 5 percent contribution regardless of the employee's decision. The maximum level of income on which the contribution is calculated is HK$20,000. Therefore, if an employee's monthly salary exceeds HK$20,000, the employer and the employee will each be required to contribute only 5 percent of HK$20,000 and thereby make a total contribution of HK$2,000 per month.

Mandatory contributions are fully vested immediately. Generally, MPF benefits must be preserved until retirement at age 65 or until the age of 60 for workers who retire early. Before the MPF came into force, only about one-third of the workforce of 3.2 million between the ages of 18 and 65 had some form of retirement protection apart from the means-tested social security benefits. As of now, this proportion has risen to around 85 percent.

Sub-Saharan Africa

African populations, on an average, are young compared to other continents. The ratio of the population over 60 to total population in the continent stood at 4.7 in 1995, the lowest in the world. Likewise, the ratio of population over 60 to the population between 15 and 60 stood at 9.3 – also the lowest in the world. In the long-term, expected changes in the fertility and mortality rates will reduce population growth rates and eventually increase the proportion of the elderly in the population. But this transition will take a long time to materialise; the bulk of the African population will continue to be young for quite some time.

Most of the people in sub-Saharan Africa are still employed in agriculture, whether they are classified as living in the rural or urban areas. Urban centres have yet to generate significant sources of steady employment. So, most people's incomes are subject to the variations of agricultural activity or the fortuity of informal activities, which themselves may fluctuate considerably. The formal sector where people have continuous employment and regular income is very small.

Most African countries have some form of social security arrangement for people working in the public sector, in state enterprises, or in the enterprises in the modern sectors. As regards pensions, coverage is low, both in terms of the total number of contributors from among the economically active labour force, and the number of beneficiaries as compared to the population over 60. Pensions of civil servants are paid out of the budget and there is no pension fund *per se*.

There is, however, a wide variety of private pension arrangements in Africa. Some of these are set up by individuals while others have been established by companies, with contributions both by employers and employees. Three factors seem to favour the emergence of private pension arrangements: (i) low contribution rates, (ii) adequate tax treatment that allows a deduction for investments in pension funds, both for the employers and the employees, and (iii) a working financial sector with some tradition in the management of pension accounts. These pension accounts can be of different types: defined-contribution, defined-benefit, and provident fund.

Provident funds focus exclusively on retirement and do not include other benefits. They operate as compulsory individual savings accounts, with beneficiaries entitled to a lump-sum payment at retirement. Although annuities are possible, often people prefer to take the lump-sum. Several provident funds have been transformed into social security arrangements with pensions organized around a defined-benefit principle. This has already happened in countries like Ghana and Nigeria.

The state has played and continues to play an important role in the development and design of the formal pension and social security systems. The oldest arrangements have been those covering public servants. Some of these continue from the former colonial times, with few changes. Moreover, in many countries a considerable percentage of the people covered by formal social security schemes are either employed by the state or by state enterprises.

However, in many of the countries in the continent, formal institutions, public or private, lack credibility. This factor extends to social security institutions, especially pensions, and derives from the poor services provided to beneficiaries and the mismanagement of pension reserves. This generalized lack of credibility severely constrains the development of social protection mechanisms that necessarily have to rely on savings and insurance to meet economic uncertainties.

At the root of the poor governance is a faulty institutional design. In many countries, the key problem has been the interference of the government in the management of the funds. This interference has been encouraged by institutional designs that give the government control of governing boards and the social security administrations.

In most countries of sub-Saharan Africa, social security organizations face considerable administrative difficulties. There have been problems with the quality of the services delivered. Good record keeping, which is crucial to a well-managed social security administration, has been lacking. Funds have had problems with the tracking of individual accounts or producing the updated valuations of the participants' assets. The end-result has been long lags between retirement and the time beneficiaries begin receiving pension payments. Also, the lack of adequate record-keeping provides an opportunity for corrupt practices as it makes it difficult to control the oft-found practice of creating fake employment files to collect pensions.

In almost all countries, government either borrowed or appropriated resources from the pension funds. The ways in which this was done vary by country. Only in a few countries have treasuries issued debt at market interest rates to the pension funds. As a consequence, in many cases the interest rates have been below market returns, and in some cases below inflation. The end-result has been that pension funds are not adequately funded. This poses problems in provident funds and in defined-benefit arrangements.

Over time, pension obligations have grown faster than contributions. This may appear odd in countries with young populations and fast growing economically active populations. However, the number of beneficiaries contributing to the formal pension funds has stagnated over the last decade, while the average age of its membership has increased. As a consequence, the ratio of beneficiaries over contributors has increased dramatically over time, resembling the characteristics of a quickly maturing pension system. It is likely that this situation will worsen in the near future, as membership in the formal pension systems is still linked to public sector employment, and civil service reforms and privatization are slowing or even reducing the employment provided by the public sector and its institutions.

East Asia

Government expenditure on social security and welfare in East Asia is lower than in most other regions. The countries in this region have been spending around 1.0 percent of the total government spending on social security and welfare compared with 12.7 percent in OECD countries, 3.6 percent in Latin America and 2.2 percent in South Asia. Governments have instead committed large sums to the public provision of basic education and health services.

Most of these countries have rapidly ageing populations, resulting from falling fertility and rising life expectancy at all ages. The life expectancy at age 65 currently ranges from 11 years to 16 years for men and 12 years to 19 years for women. The expected increase in life expectancy over the next 40 years is between 2 to 4 years. This has important implications for old age security, including pensions and health care.

The old age dependency ratio is still relatively low, between 5 to 9 percent but is projected to reach 27 percent by 2040, though not uniformly for all countries: while it may be only 11 percent for Cambodia, it will be close to 40 percent for Korea, underlining the fact that ageing is closely related to income levels.

At present, labour force coverage under formal retirement income provision throughout the region is generally limited. For several countries - China, Indonesia, the Philippines and Thailand – combined coverage under publicly mandated private sector and government employees' schemes is less than 30 percent. Almost invariably, public sector workers benefit from generous pension schemes unavailable to the rest of the population. However, public sector (excluding state-owned enterprises) comprises only 4 percent to 13 percent of the labour force in the region.

Formal pension systems in the region comprise of National Provident Fund systems (Indonesia, Malaysia and Papua New Guinea), traditional pension systems with defined benefits, public management and pay-as-you-go financing which are currently immature (Korea, Philippines and Thailand) , and inherited old age security systems with generous, defined benefits that are unfunded and are having a comparatively higher level of labour force coverage due to public ownership of essentially all large enterprises (China, Cambodia, Lao PDR, Mongolia and Vietnam).

For private sector workers, in countries with large agricultural and informal urban sectors (China, Indonesia and the Philippines) coverage tends to be limited to the formal urban sector. For other countries with larger formal sectors, such as Korea and Malaysia, coverage rates are higher. Korea has introduced the National Pension Scheme which now covers the rural self-employed, farmers and fishermen, and will soon be extended to the urban self-employed.

Chapter 5

The Indian Scene

More than one eighth of the world's elderly population lives in India. According to a report recently released by the population division of the UN Department of Economic and Social Affairs, the country's life expectancy is projected to increase from the current 64.7 years to 75.6 years. The number of Indians aged above 65 is expected to quadruple from 64 million in 2005 to 239 million in 2050, and those above 80 would have increased from the current number of 7.8 million to 51.4 million. This could mean that more elderly parents will be depending on fewer children for a longer period. Social security, which is a major current global issue, assumes serious proportions for India and needs to be tackled urgently (Appendix IV).

Since independence, the Indian socio-economic system, including the pension system, has been guided largely by the notion of welfare state. These ideas were applied only to the organized sector and the implicit notion was that, over time, the unorganized sector will shrink and the modern organized sector will dominate the economy. In reality, however, even after more than 50 years of development, about 90 percent of the workforce is in the unorganized sector and it is the share of the organized sector that is shrinking. Thus, we have a structure of pension system in India in which a small privileged minority, consisting mainly of civil servants and industrial workers, receives pension benefits on a generous scale, while the vast majority has very little social protection.

Persons employed in industrial establishments are compulsorily covered by the Employees Provident Fund (EPF) Act of 1952. This Act is currently applicable to factories and establishments employing more than 20 workers. The wage ceiling for coverage under the EPF scheme presently stands at Rs.6,500 per month.

Under the EPF Act, the employees are eligible for defined benefits that are paid out of the contributions from employers and employees, plus the accrued interest on the accumulations. They are also entitled to pension related to the final salary drawn by them.

EPFO – Taxing the Non-rich

Only a very cynical politician can plan a scheme that taxes and threatens to rob the not-so-well-off while giving them the impression they're better off for all the caring. This is precisely what the government did when, last fortnight, it decided it would extend the coverage of the Employees Pension Fund Organisation (EPFO) from units that employ 20 or more persons to units employing more than 10 persons.

The EPFO is in terrible shape. It has an antiquated single-entry book keeping system that makes it impossible to trace any fraud that happens; while the pension scheme was based on the understanding that the EPFO would be able to earn at least an 11.5 per cent return on its investments, the current earnings are around 8 per cent — which is why, with each passing year, the hole in the EPFO rises dramatically (it is currently around Rs 25,000 crore and even that could be a huge underestimate). In other words, extending the EPFO's coverage at a time when it is bleeding and in terrible shape, will probably ensure it collapses.

The EPFO has not been able to modernise its systems in order to be able to offer a single unique identification number to subscribers — so, if you keep shifting jobs, it is very likely your accounts will never be consolidated in one account. Most people have at least 2-3 EPF accounts, and the problem will be a lot more severe in the case of small organisations (shops, construction sites, beedi workers, etc) where migration and frequent job changes are de rigeur.

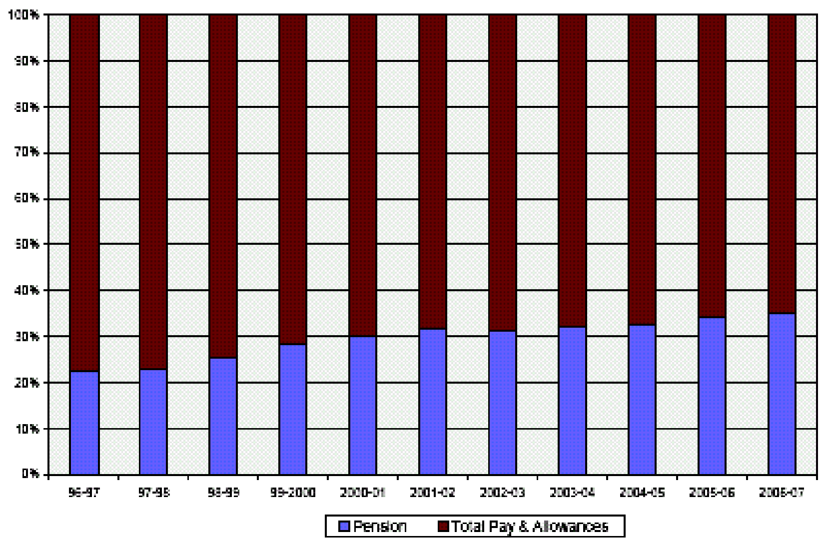
(Business Standard, New Delhi, July 14, 2008)

Workers in the organised sector constitute a small fraction of the country’s labour force. Government employees are eligible for a non-contributory, defined-benefit pension funded by the state. In addition, most civil servants enjoy coverage under a government provident fund. Contributions by government servants to the provident funds are part of the public accounts. Pension benefits are, however, paid out from tax and non-tax revenues of the government. The system for the state government employees is also generally the same as for the employees of the central government.

The Report of the Sixth Central Pay Commission states that the Government of India's expenditure on pensions was Rs.7,956 crore in 1996-97 before implementation of the recommendations of the Fifth CPC. It increased to Rs.28,928 crore in 2005-06 and is placed at Rs.31,350 crore in 2006-07 resulting in an increase of 294 percent within a span of ten years from 1996-97 to 2006-07.

Currently, the pension outflow constitutes 35 percent of the total central government expenditure on account of salaries, allowances and pension (Figure 3).

Figure 3: Share of Pension in Total Expenditure: Govt. of India



Source: Report of the Sixth Central Pay Commission (March 2008).

With escalating pension liabilities of its employees, the central government has introduced a new pension scheme for those joining service on or after January 01, 2004. This scheme will be based on defined-contributions, both from the employees and the government, which will then be invested in the market through approved fund managers. The yield from such investments will be accumulated, and together with the contributions shall constitute each employee's retirement benefit.

In the unorganized sector, however, bulk of the workers is either self-employed or employed in casual wage employment. The social security currently provided to this segment of the population consists of several measures like social insurance, social assistance, social protection and social safety net, etc. However, the coverage under all these measures is just over 10 million out of an estimated 370 million workers in the unorganized sector. The neglect of the conventional social security benefits for the poor workers is based on the assumption that in a country like India, poor workers are so numerous and the problem of absolute poverty is so massive that putting in place a comprehensive social security arrangement would be fiscally impossible.

There are a number of models of providing social security to the workers in the unorganized sector. These may be classified as under:

- Centrally funded social assistance programme
- Social insurance scheme
- Social assistance through welfare funds of central and state governments
- Public initiatives

Social assistance programmes have been introduced at the central and state levels.

National Social Assistance Programme

National Social Assistance Programme (NSAP) was included in the Central Budget for 1995-96. In providing social assistance benefits to poor households in the case of old age, death of the breadwinner and maternity, the NSAP aims at ensuring minimum national standards, in addition to the benefits that the states are currently providing or might provide in future. The intention in providing 100 percent central assistance is to ensure that social protection to the beneficiaries everywhere in the country is uniformly available without interruption. The NSAP provides opportunities for linking the social assistance package to schemes for poverty alleviation and provision of basic needs.

The NSAP presently includes three benefits as its components, viz.,

(i) National Old Age Pension Scheme (NOAPS)

(ii) National Family Benefit Scheme (NFBS)

(iii) National Maternity Benefit Scheme (NMBS).

The scales of benefit under the NSAP are as follows:

- National Old Age Pension Scheme (NOAPS): Rs.75/- per month per beneficiary.
- National Family Benefit Scheme (NFBS): Rs.10, 000/- in case of death of the primary breadwinner to the bereaved household.
- National Maternity Benefit Scheme (NMBS): Rs.500/- per pregnancy up to the first two live births.

Since 2007, India has extended its means-tested National Old-Age Pension Scheme (NOAPS) to all citizens aged 65 or older below the poverty line and removed restrictions on the number of recipients per household. Before this policy change, only one NOAPS pension was provided per household, and recipients were limited to individuals with little or no income, family financial support, or any other means of livelihood. NOAPS beneficiaries may receive as much as Rs.400 each month; the central government finances half (Rs.200) and encourages state governments with elderly residents covered by NOAPS to match that amount. According to government estimates, the actual number of persons aged 65 or older receiving NOAPS is around 3.5 million, or roughly 7 percent of the total number of those aged 65 or older.

Several states such as Gujarat, Karnataka, Andhra Pradesh, Kerala, Maharashtra, and Tamil Nadu have established pension schemes for agricultural workers as well. Because of the limited financial resources available, these schemes benefit only a fraction of the elderly and only those who are destitute. Moreover, owing to a wide gap between resource availability and needs, selection and grant of these pensions are not always transparent. For instance, under NOAPS the centre has fixed an arbitrary ceiling formula under which only 50 percent of those eligible for benefits under the scheme are to be granted pension benefits. This leaves the district administration and *panchayats* with considerable leverage and subjective decisions.

The Government of India has set up several welfare funds for workers in specific occupations for whom no direct employer-employee relationship exists. The resources are raised by the government on non-contributory basis and the delivery of welfare services is effected without linkage to individual worker's contribution. These funds are constituted from the 'cess' collected from the employers and manufacturers/ producers of a particular industry/commodity and are mainly targeted to provide medical care, assistance for education of children, housing, water supply and recreation facilities. A large portion of the fund is diverted as financial assistance for the education of the children of the workers from primary school to graduation and post-graduation levels. The government has also enacted a central legislation towards creation of welfare funds at the state level for the building and other construction workers; there are around 20 million construction workers in the country.

The welfare fund model has also been successfully implemented by several states for various categories of workers. Prominent among the states are Kerala and Tamil Nadu. In

Kerala, for instance, the government took the initiative to set up a welfare fund through contributions from workers, employers, and the government. The model is so popular that some of the other states like Andhra Pradesh and Karnataka are in the process of bringing out their own legislation for creation of welfare funds for the unorganized sector workers with the object of providing them social security.

Although the coverage is not high, several state governments have attempted to provide various protective social security measures for the unorganized poor and vulnerable sections of the society. For instance, successive governments in Kerala have introduced a large number of social security and welfare schemes with a view to attaining the goal of reducing income insecurity among the weaker segments of the society. There are as many as 30 social security and welfare schemes in Kerala. The most important schemes in terms of coverage are old age pensions for the destitute and rural labourers.

Tamil Nadu too has been a pioneer in implementing protective social security. Old age pension scheme was probably the first significant scheme of this type to be initiated in the state in 1962. After that, many pension schemes and welfare programmes have been introduced. Some of them are: the Tamil Nadu old age scheme for destitute widows (1975); destitute physically handicapped pension scheme (1974); unemployment relief scheme (1980); self-employment promotion scheme (1983); and old age pension scheme for destitute agricultural labourers (1981).

The central and the state governments have also launched several social insurance schemes for the benefit of the weaker sections through the Life Insurance Corporation of India and General Insurance Corporation of India.

India’s social security expenditure is a relatively small part of GDP and total public expenditure: 4-5 percent in case of the former and 14-16 percent in the case of the latter. This is far lower than what is prevailing in the developed OECD countries where the percentages range from 8-19 percent of GDP.

The informal sector group which is above the poverty line may constitute as much as 60 percent of the workforce in India. The task of the public policy is to see if the old age security need of this group can be met through some flexible pension plans which can inspire the trust of this group and has low transaction costs. For the 30 percent people below the poverty line, however, safety net schemes are the only realistic options; these schemes could be integrated with the poverty reduction programmes.

Chapter 6

Prospects for Developing Countries

All evidence suggests that a large number of the elderly in developing countries have no access to pensions and have few other resources to fall back upon. Hence, they are either poor or at major risk of poverty. The poor whose incomes are seldom above subsistence level in these countries may perhaps be able to cope with some fluctuations in income, but their ability to accumulate assets or to rely on family support is limited, particularly if they run into serious and continued financial difficulties.

Developing countries differ structurally from developed countries in several ways. They are characterised by higher poverty levels, more unequal distribution of income and a larger informal sector. Their per capita income level at an average of $1,750 also stands out in marked contrast to the average of $35,000 in developed countries. The size of the informal sector in these countries has also been increasing. In Kenya, for example, informal employment accounted for almost two-thirds of total urban employment in i996 compared with just 10 percent in 1972. In India, if agriculture is included, more than 92 percent of workers are employed in the informal sector where there is little or no security of employment.

Low coverage of old-age protection systems is an added cause of serious concern in developing countries. While most countries mandate that workers make contributions to a retirement-savings plan of some kind, fewer than ten percent comply in South Asia and Sub-Saharan Africa. Coverage is less then 30 percent in most of East Asia, and around 30-40 percent in middle- income Latin American countries. It reaches an average of 60 percent in the transition economies of Eastern Europe and the former Soviet Union. In contrast, higher-income OECD countries manage to cover 80 percent or more of their workforce. It would appear that economic development is the major determinant of such coverage.

In industrial countries, social security is associated with such programmes as pensions, unemployment and health care, but such associations are not particularly helpful in assessing its role in developing countries. The types of social security policies implemented in industrialized countries may be too costly to be put into practice in poor economies. Hence, in developing countries the role of social security policies has to be enlarged: in addition to serving as a safety net, they also need to safeguard against rising levels of deprivation. Adequately targeted policies could increase the productive capacity of the poor and thus increase their potential to secure employment and higher incomes.

The introduction of social security programmes in developing countries is a difficult task given that the budget restrictions are high and there are high levels of poverty which require social programmes of a magnitude that few governments in developing countries are able or willing to implement. According to Jean-Jacques Dethier, developing countries face following difficulties in extending coverage to the informal sector workers:

(i) *Fiscal constraints* – The general level of taxation required for universal social insurance is much higher than what is currently in place in most countries. Public spending on social security averages 15 percent of GDP, which is about half of what it is in developed countries.

(ii) *Administrative constraints* – Means testing is difficult in the absence of official records of income. There is also potential of misuse of funds, and corruption may lead to diversion of funds to non-poor beneficiaries.

However, one is encouraged by the experiences of economies such as China, Costa Rica, Chile, Cuba, Sri Lanka and the Indian state of Kerala that systems of socio-economic protection based on efficiently targeted policies and careful integration of social and economic policies can help in maintaining the living standard and well-being of more vulnerable groups in the population.

The governments of the developing countries thus have to devise ways to target benefits that can reach the poor who are not covered by formal social insurance. They have also to evaluate the objectives of social security and decide whether to rely on public or private insurance. Given that administrative costs make up a significant part of formal social security systems, the choice between public and private provision has to take into account not only the relative costs but also other issues, such as the market structure, etc. The relevant policy in developing countries will depend on identifying vulnerable groups as well as the administrative and political constraints.

Appendix I

Coverage under Contributory Programme

OECD Countries

Country	Year	Contributors/ Labour Force	Contributors/Working Age Population
		Percentage	
Canada	1992	91.9	80.2
France	1993	88.4	74.6
Germany	1995	94.2	82.3
Italy	1997	87.0	68.0
Japan	1994	97.5	92.3
Netherlands	1993	91.7	75.4
Sweden	1994	91.1	88.9
Switzerland	1994	98.1	96.8
United Kingdom	1994	89.7	84.5
United States	1993	94.0	91.9

Latin America and the Caribbean

Country	Year	Contributors/ Labour Force	Contributors/Working Age Population
		Percentage	
Argentina	1995	53.0	39.0
Bolivia	1999	14.8	13.3
Brazil	1996	36.0	31.0
Chile	2001	54.8	34.9
Colombia	1999	35.0	29.3
Costa Rica	1998	50.6	38.5
Mexico	1997	30.0	31.0
Nicaragua	1999	14.3	13.3
Paraguay	2001	14.0	9.2
Peru	2001	41.0	25.0
Venezuela	1999	23.6	18.2

Eastern Europe and Former Soviet Union

Country	Year	Contributors/ Labour Force	Contributors/Working Age Population
		Percentage	
Croatia	1997	66.0	57.0
Czech Republic	1995	85.0	67.2
Hungary	1996	77.0	65.0
Kazakstan	2001	38.3	28.3
Latvia	1995	60.5	52.3
Poland	1996	68.0	64.0
Slovakia	1996	73.0	72.0
Ukraine	1995	69.8	66.1

North Africa and the Middle East

Country	Year	Contributors/ Labour Force	Contributors/Working Age Population
		Percentage	
Algeria	1997	31.0	23.0
Egypt	1994	50.0	34.2
Iran	2000	48.2	25.2
Morocco	2000	17.3	11.3
Tunisia	2000	40.0	23.0
Turkey	1997	37.1	27.4

Sub-Saharan Africa

Country	Year	Contributors/ Labour Force	Contributors/Working Age Population
		Percentage	
Burkina Faso	1996	4.8	-
Cape Verde	1997	20.0	18.0
Cote'Ivoire	1997	9.3	9.1
Ghana	1993	7.2	9.0
Mauritius	1995	60.0	57.0
Nigeria	1993	1.3	1.3
Senegal	1998	4.3	4.7
Zambia	1994	10.2	7.0
Zimbabwe	1995	12.0	10.0

Asia and the Pacific

Country	Year	Contributors/ Labour Force	Contributors/Working Age Population
		Percentage	
Bangladesh	1993	3.5	2.6
China	1994	17.6	17.4
India	1992	10.6	7.9
Korea, Rep.	1996	58.0	43.0
Malaysia	1993	48.7	37.8
Pakistan	1993	3.5	2.1
Philippines	1996	28.3	13.6
Singapore	1995	73.0	56.0
Sri Lanka	1992	28.8	20.8

Source: 'Old Age Security and Social Pensions' by Anita M. Schwarz – World Bank, May 2003.

Appendix II

Types of Mandatory Systems for Retirement Income

Country	Flat rate	Earnings-related	Means-tested	Flat rate universal	Provident funds	Occupa-tional retirement schemes	Individual retirement schemes
Armenia	X[a]		X				
Australia			X			X	
Azerbaijan		X	X				
Bahrain		X					
Bangladesh			X				
Brunei				X	X		
China	X[a]						X
Fiji					X		
Georgia	X		X				
Hong Kong			X			X	
India		X	X		X		
Indonesia					X		
Iran		X					
Israel	X						
Japan	X	X					
Jordan		X					
Kazakhstan		X	X				X[c]
Kiribati					X		
Korea, South		X					
Kuwait		X					
Kyrgyzstan		X	X				
Laos		X					
Lebanon		X					
Malaysia					X		
Marshall Islands		X					
Micronesia		X					
Myanmar	B						
Nepal				X	X		
New Zealand			X	X			
Oman		X					

Pakistan		X					
Palau		X					
Papua New Guinea						X	
Philippines	X[b]						
Saudi Arabia		X					
Singapore					X		
Solomon Islands					X		
Sri Lanka					X		
Syria		X					
Taiwan		X					
Thailand		X					
Turkey		X					
Turkmenistan		X	X				
Uzbekistan		X	X				
Vanuatu					X		
Vietnam		X					
Western Samoa				X	X		
Yemen		X					

Note: The types of mandatory systems for retirement income are defined as follows:

(i) Flat-rate pension: A pension of uniform amount or one based on years of service or residence but independent of earnings. It is financed by payroll tax contributions from employees, employers, or both.

(ii) Earnings-related pension: A pension based on earnings. It is financed by payroll tax contributions from employees, employers, or both.

(iii) Means-tested pension: A pension paid to eligible persons whose own or family income, assets, or both fall below designated levels. It is generally financed through government contributions, with no contributions from employers.

(iv) Flat-rate universal pension: A pension of uniform amount normally based on residence but independent of earnings. It is generally financed through government contributions, with no contributions from employers or employees.

(v) Provident funds: Employee and employer contributions are set-aside for each employee in publicly managed special funds. Benefits are generally paid as a lump-sum with accrued interest.

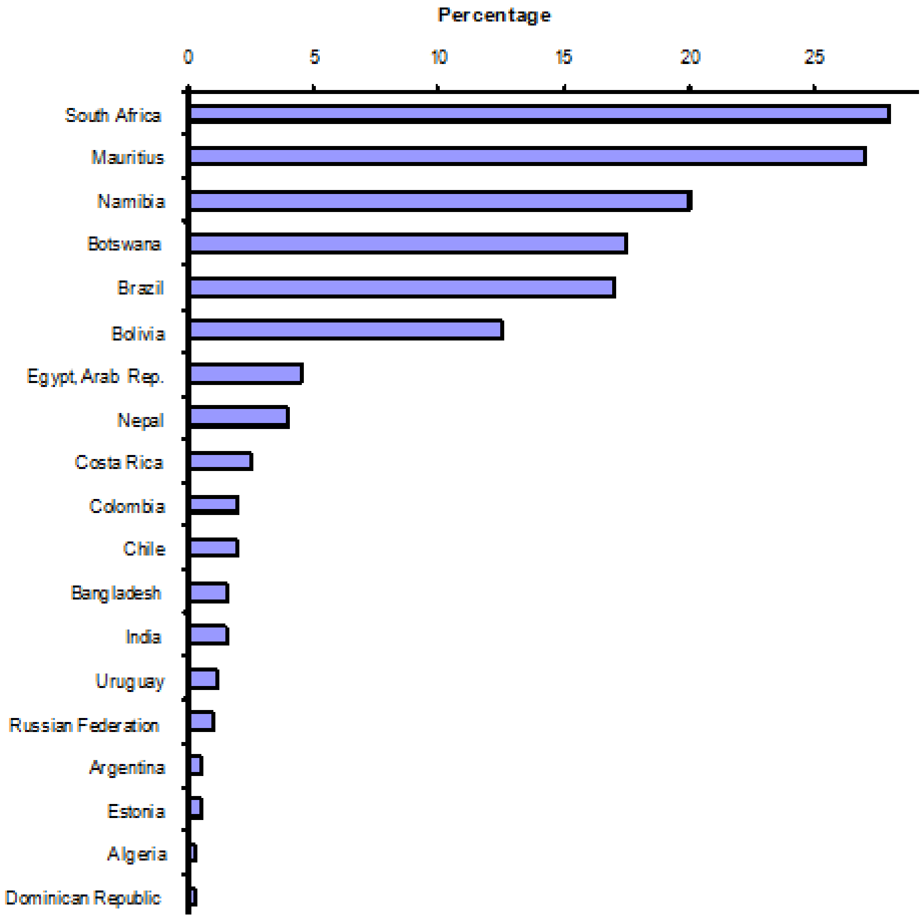
(iv) Occupational retirement schemes: Employees and, in some cases, employers must contribute a certain percentage of earnings to an individual account managed by a public or private fund manager chosen by the employee. The accumulated capital in the individual account is used to purchase an annuity, make programmed withdrawals, or a combination of the two and may be paid as a lump-sum.

(a) The benefit formula contains a flat-rate component as well as an element based on earnings or years of coverage. (b) No mandatory system for retirement income. (c) The government provides a guaranteed minimum pension.

Source: Social Security Programmes throughout the World: Asia and Pacific (2006) – Social Security Administration, USA.

Appendix III

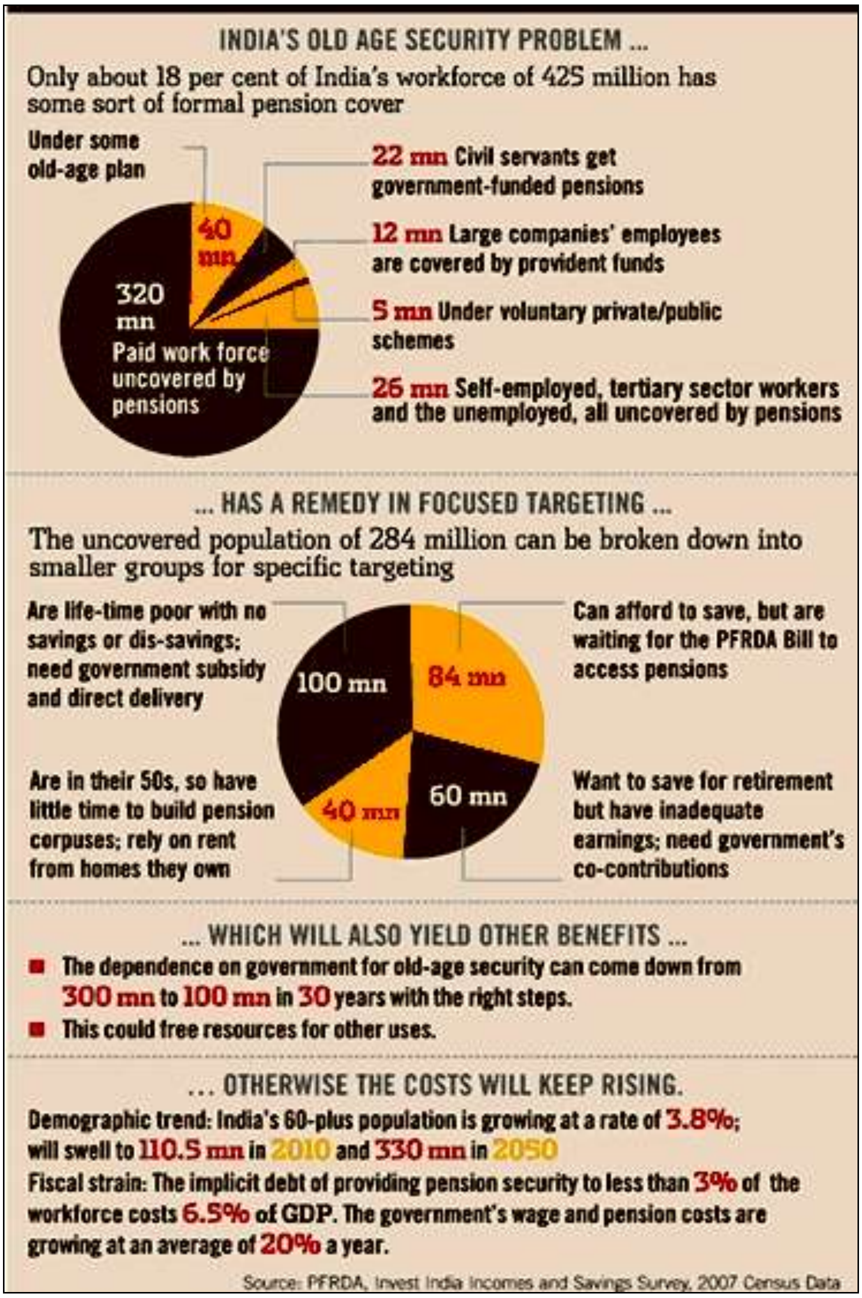
Social Pension Impact Index, Selected Countries



Source: Palacios and Sluchynsky in 'The Role of Social Pensions'

Appendix IV

Social Security in India



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