

Types of Social Pensions  
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Non-contributory pensions, known popularly as “social pensions”, are a tool used by governments to ensure against – or at least alleviate – poverty of citizens and residents in old age. Social pensions differ from contributory pensions in that eligibility depends only on age, residence/citizenship and (possibly) need. The recipient of a social pension need not have worked for wages, and the amount of benefit does not vary with her earnings or contribution history. Benefits can vary for reasons unrelated to employment history: higher, for example, when a pensioner has dependents, lower when two pensioners are married and share accommodations, or much lower – often zero – due to government assessment of need.

This is my personal attempt to classify social pensions, with clear definitions. I intend to stick to these definitions in future writings. I can only impose rules on myself, but hope that others will find this taxonomy useful. Social pensions are equivalent to what the World Bank (2005) has come to refer to as a ‘zero pillar’. This differs from the World Bank’s broader (1994) pillar 1, which included all basic pensions, contributory as well as non-contributory.

I divide social pensions into four broad groups: Universal Pensions, Universal Minimum Pensions, Recoverable Social Pensions and Social Assistance Pensions. **Universal Pensions** are distributed to all residents (or citizens) who meet age and residency requirements, regardless of their income or wealth. Eligibility for other types of social pensions requires proof of need, in addition to proof of age and residence. A **Universal Minimum Pension** is perhaps the lightest test of need, promising full benefits for those with no other relevant pension income, and partial benefits for those with pension income that is less than the social pension. A **Recoverable Social Pension** is universal, in the sense that everyone who satisfies age and residence requirements is eligible to receive it, but it is income-tested through the tax system. Beneficiaries must include the social pension in their annual income tax returns, and are liable for a surcharge – higher than the normal rate for their tax bracket – up to the point where the full amount of the pension is recovered by tax authorities. Finally, **Social Assistance Pensions** require applicants to pass a means test, proving that they are poor enough to merit a non-contributory pension. It is useful, I believe, to divide this large group into two subgroups: those for which the test applies to the income (and/or wealth) of the individual or married couple (**individual test**) and those for which it applies to the income (and/or wealth) of the entire family or household (**family test**).

Details follow for each group of social pensions.

**1. Universal Pension** (also known as "demogrant", "categorical pension", "citizens pension")

Age and residence/citizenship are the only tests for this pension. It is not necessary to actually retire from work to receive the pension. Benefits might be taxable as income, but only at normal rates, without surcharges to recover them. With a progressive tax

system, receipt of a pension might shift a worker into a higher tax bracket, which would discourage working beyond the state pension age. Some countries for this reason offset this tax by granting a larger tax-free income allowance to taxpayers who reach pensionable age.

I once classified pensions with very strict residence requirements as "residence-based pensions". I now think that they should be grouped with "universal pensions", regardless of how strict the residence requirements might be. The Netherlands, for example, requires 50 years of residence between the ages of 15 and 65 for a full and very generous social pension. Applicants with fewer years of residence receive 2% of the full pension for each year of residence. I would now classify this as a universal pension, even though the pension is tiny for someone who has been away for most of the prime years of his or her adult life.

A universal pension is not necessarily a generous pension. Hong Kong's 'fruit money' (HK\$1090 - about 100 euros - a month from age 70) is a universal pension, even though it is strikingly small relative to incomes in a city as wealthy as Hong Kong. Other (more generous) examples of universal pensions are New Zealand and Mauritius in addition to The Netherlands.

**2. Universal Minimum Pension.** This is sometimes lumped with type #1 and labelled "universal" or "citizens" pension, but I think it is important to place this pension in a distinct category.

The benefit is pension-tested, i.e. reduced if the beneficiary receives other income from a pension. Sweden pioneered this scheme in 1913, and to this day tops up tier 2 (contributory) pensions and provides a full non-contributory pension to those without a contribution history. Income from voluntary (tier 3) pensions do not affect eligibility for the social pension. Every person in Sweden who satisfies age and residence requirements is guaranteed a minimum pension for life.

Lesotho and Mexico's federal government achieve the same result by restricting pensioners to a single public pension: those who are eligible for a more generous public pension will not, then, exchange it for a basic minimum pension. In these two countries, as in Sweden, this is equivalent to recovery of the minimum pension from other public pension income at the rate of 100%.

Sweden differs from Lesotho and Mexico in disregarding income from the occupational pensions of government employees. It is true that occupational pensions represent earned income, albeit deferred earnings, so to include this type of pension converts the test into an income test. I have agonized over this, and reached the conclusion that it is better to let this category include tests of *any* pension income. My reasoning is that what matters is the pension income that individuals have in old age, irrespective of what they may have earned and saved while working. It is not unreasonable, especially, to treat civil service pensions in the same fashion as pensions of government mandated schemes. I leave open the possibility of including purely private pension income (occupational or personal) in this test, but know of no examples. There are unlikely to be any, since including them in the test amounts to a tax on income from retirement saving, which would offset – thus weaken – the

subsidies and tax breaks that nearly all governments provide to encourage retirement saving.

Many countries with a Universal Minimum Pension have introduced a 'taper' that allows beneficiaries to retain some of the non-contributory pension provided employment-related pension income is not too high. Norway, for example, recently introduced a taper of 20%, which means that a worker can earn an employment-related (tier 2) pension equal to 125% of the minimum pension before losing all of the non-contributory benefit. Finland has a taper of 50%, so a worker in that country can receive up to double the amount of a full minimum pension before losing all rights to a non-contributory benefit.

**3. Recoverable Social Pension.** I once called this an "ex post means tested pension", but no longer like that name, so am trying this as an alternative.

This pension is universal, in the sense that anyone satisfying age and residence/citizenship requirements is entitled to receive it, but the benefit must be declared as income and - moreover - will be subjected to recovery by a surcharge on other taxable income until the full benefit is recovered. Any benefit left after paying the surtax is taxed at normal rates.

This is an income test, but a very non-invasive one, which is based only on taxable income. It treats beneficiaries as individuals rather than members of a household, and possession of physical assets or savings does not affect the amount of benefit retained. As a result, stigma is not a problem and non-take-up is common only for those whose income is so high that they have no hope of retaining any of the benefit.

There are few examples of this type of pension, which is a pity, since it is a better vehicle for poverty alleviation than the very popular "Social Assistance Pension". Contemporary examples of this type of pension are Canada and (I think) some of the Nordic countries: Denmark, Finland and Iceland. New Zealand provides a historical example. I am most familiar with Canada, which 'claws back' its previously universal Old Age Pension with a 15% surcharge on income after a generous exempt amount. Any benefit left after paying the surcharge is included in taxable income and taxed at normal rates. This is a tax especially on retirement savings, which is odd since the government provides generous tax incentives for retirement saving. The Government of Canada subsidizes retirement saving in the accumulation phase, then taxes savings at a punitive rate when they are withdrawn.

**4. Social Assistance Pension.** All other social pensions fall into this category. I used to call this an "ex ante means tested pension", but recently came up with what I hope is a more palatable name.

It is very important, in application of means tests, whether the income (and wealth) of the individual is considered, or that of his entire family or household. If adult children are legally required to support their parents, this can lead to stigma and discourage applications from elderly persons living in extreme poverty. I have not paid as much attention to this detail as I now think it merits, so recommend splitting this

heterogeneous group into two parts: **individual tests** and **family tests**. For alleviation of poverty, the former test is preferable to the latter.

A further division might be by the percentage of the elderly population that receive social assistance pensions, thus distinguishing between countries with ample coverage, such as South Africa and Australia, from those with small coverage, such as India and the United States. I doubt that this is useful. First, where do we draw the line? This is arbitrary and difficult to determine. Second, a country might have a large coverage of workers in tier 2 (contributory pensions), which means that tier 1 (non-contributory) coverage must be low by definition.

It is very common to find that countries with one of the other three types of pensions also have assistance pensions. This is an indication that the country's other pension is too small to keep the elderly from falling into poverty. Hong Kong's small universal pension, which is supplemented by a more generous but tightly targeted social assistance pension, is a clear example. Another example is Canada, which has a Guaranteed Income Supplement (GIS) to supplement its recoverable Old Age Pension, and the GIS is roughly as large as the full OAP. Chile has in place what would be a Universal Minimum Pension, except for the requirement that beneficiaries also belong to a household with income in one of the poorest three quintiles. This transforms it into a Social Assistance Pension, although a very unusual one.

Very common in contributory (Tier 2) schemes is a "minimum pension guarantee". This is not a social pension, even though it is almost always funded from general government revenue, so is not included in this taxonomy. Spain, for example, guarantees a generous minimum pension to all workers with at least 15 years of employment history, no matter how small the wages (hence the contributions).

## References

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