Universal Age Pensions

Larry Willmore

Strategies for the Extension of Social Protection

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Traditional three pillars

1. Public pensions
2. Occupational pensions
3. Personal pensions

World Bank’s three pillars (1994)

1. Basic pension
2. Mandatory earnings-related pension
3. Voluntary saving

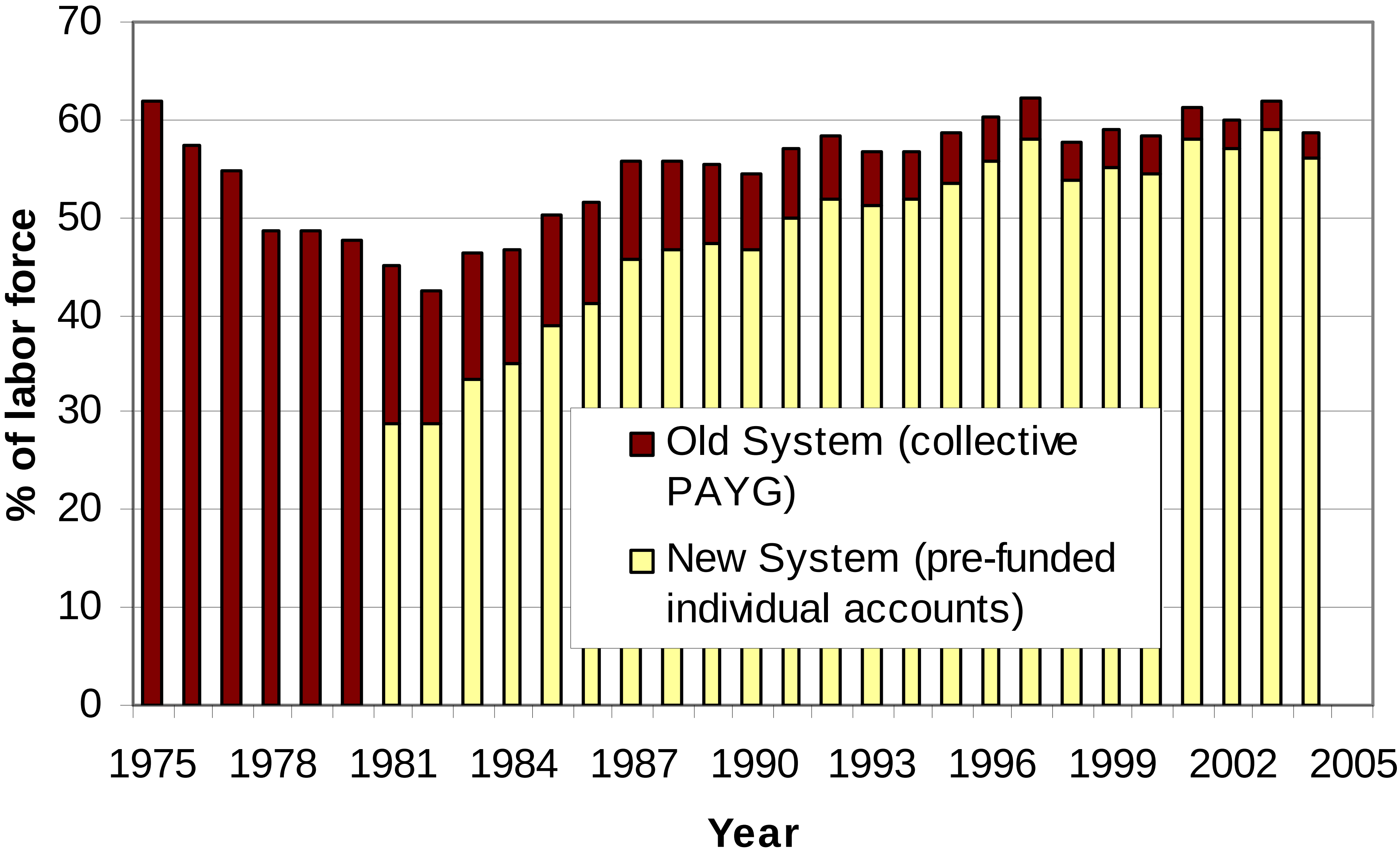
World Bank's five pillars (2005)

0. Non-contributory basic pension
1. Public earnings-related pension
2. Private earnings-related pension
3. Occupational or personal pension
4. Other retirement savings, government services, informal support from family and community

“Extending coverage by requiring low income informal sector workers to contribute to social security would not be in the best interests of these workers ..., even if the government had the capacity to enforce the mandate.”

-- Estelle James (World Bank), 1999.

Pillar 2 pension coverage in Chile



Three pillars or two?

"The ability to retire in a degree of personal comfort, without worry and with dignity, is the least that citizens can expect in a modern, developed economy…. [I]t is also most they can expect. They cannot expect the state to maintain in retirement the incomes people became accustomed to during their working lives"

Dr. Michael Cullen, New Zealand's Finance Minister, 13 June 2003.

Six types of Pillar 1 pensions

Contributory (2)

- Flat pension
- Minimum pension guarantee (or flat top-up) for Pillar 2 pensions

NB: These are excluded from the World Bank’s five-pillar system.

Six types of Pillar 1 pensions

Non-contributory (4)

- Universal NMT pension
- Residence-based pension
- Recovery-conditioned pension (*ex post* means test)
- Social assistance pension (*ex ante* means test)

Advantages of universal pensions

- Simple and easy to administer
- Automatic, 100% coverage
- Reach women and rural areas
- Do not stigmatize recipients
- Broad political support
- Avoid disincentive to save for old age
- Avoid disincentive to work in old age

The cost of universal pensions

r = ratio of eligible to total population

p = ratio of pension to per capita GDP

y = per capita GDP

t = ratio of pension taxes to GDP

ty = tax revenue per capita

rpy = pension expenditure per capita

The cost of universal pensions

Taxes=Expenditures

$$ty = rpy \qquad (1)$$

Solve for rate of tax:

$$t= rp \qquad (2)$$

Example: $t=(0.1)(0.3)=0.03$ (3% of GDP)

Universal NMT pensions

1. New Zealand - 1940
2. Mauritius – 1958
3. Brunei - 1984
4. Namibia – 1990
5. Samoa – 1990
6. Nepal - 1995
7. Botswana – 1996
8. Bolivia - 1996
9. Mexico City – 2001
10. Kosovo - 2002

Universal pensions: actual values for p and t

	p=pension/y	**t=taxes/GDP**
New Zealand (65)	35% – 46%	4.3% (gross) 3.6% (net)
Mauritius (60-100)	16% – 68%	2.0%
Brunei (60)	10%	0.4%
Namibia (60)	16%	0.9%
Samoa (65)	9%	0.4%

Universal pensions: actual values for p and t

	p=pension/y	t=taxes/GDP
Nepal (75)	10%	0.1%
Botswana (65)	10%	0.5%
Bolivia (65)	26%	1.2%
Mexico City (70)	5.5%	0.2%
Kosovo (65)	50%	2.7%

Residence-based pensions
(age, basic pension as % of per capita GDP)

- Denmark (65, 21%) *
- Finland (65, 22%)
- Iceland (65, 9%) *
- Norway (67, 17%) *
- Sweden (65, 30%)
- Canada (65, 14%) *
- Netherlands (65, 39%)

* plus means-tested supplement

Recovery-conditioned pensions (*ex post* means test)

- Denmark (65)
- Finland (65)
- Iceland (65)
- Norway (67-69)
- Sweden (65)
- Canada (65)
- United Kingdom (80)
- Chile (65)

Recovery-conditioned pensions (*ex post* means test)

	pension / y	recovery rate	base
Denmark	21%	31%	earnings
Finland	22%	50%	pension
Iceland	9%	30%	income
Norway	17%	40%	earnings
Sweden	30%	100%	pension
Canada	14%	15%	income
UK	13%	100%	state pension
Chile (2008)	21%	100%	pension

Examples of social assistance pensions, 2003 (*ex ante* means test)

	coverage	maximum pension/y	Tax/GDP
South Africa	87% (65, 60)	29%	1.2%
Australia	67% (65, 62.5)	29%	2.3%
Chile	15% (65)	14%	0.15%
Costa Rica	21% (65)	10%	0.12%
USA	6% (65)	17%	0.07%
India	4% (65)	5%	0.01%

Pillar 1 in Chile (2006)

- Non-contributory Social Assistance Pension (PASIS): Ch$37.251
  - US$70 - 13% of per capita GDP

- Guaranteed Minimum Pension (PMG) (requires 240 months of contributions): Ch$87.800
  - US$163 - 31% of per capita GDP

Future Pilar 1 en Chile: Solidarity Pension System (SPS)

- Basic Pension: Ch$60.000 in July 2008
  - US$111 – 21% of per capita GDP
  - Ch$75.000 en July 2009
- Recovery from other pension income
  - 2008 100%
  - 2009 100%
  - 2010 75%
  - 2011 50%
  - 2012 37.5%

Solidarity Pension System (SPS) eligibility requirements

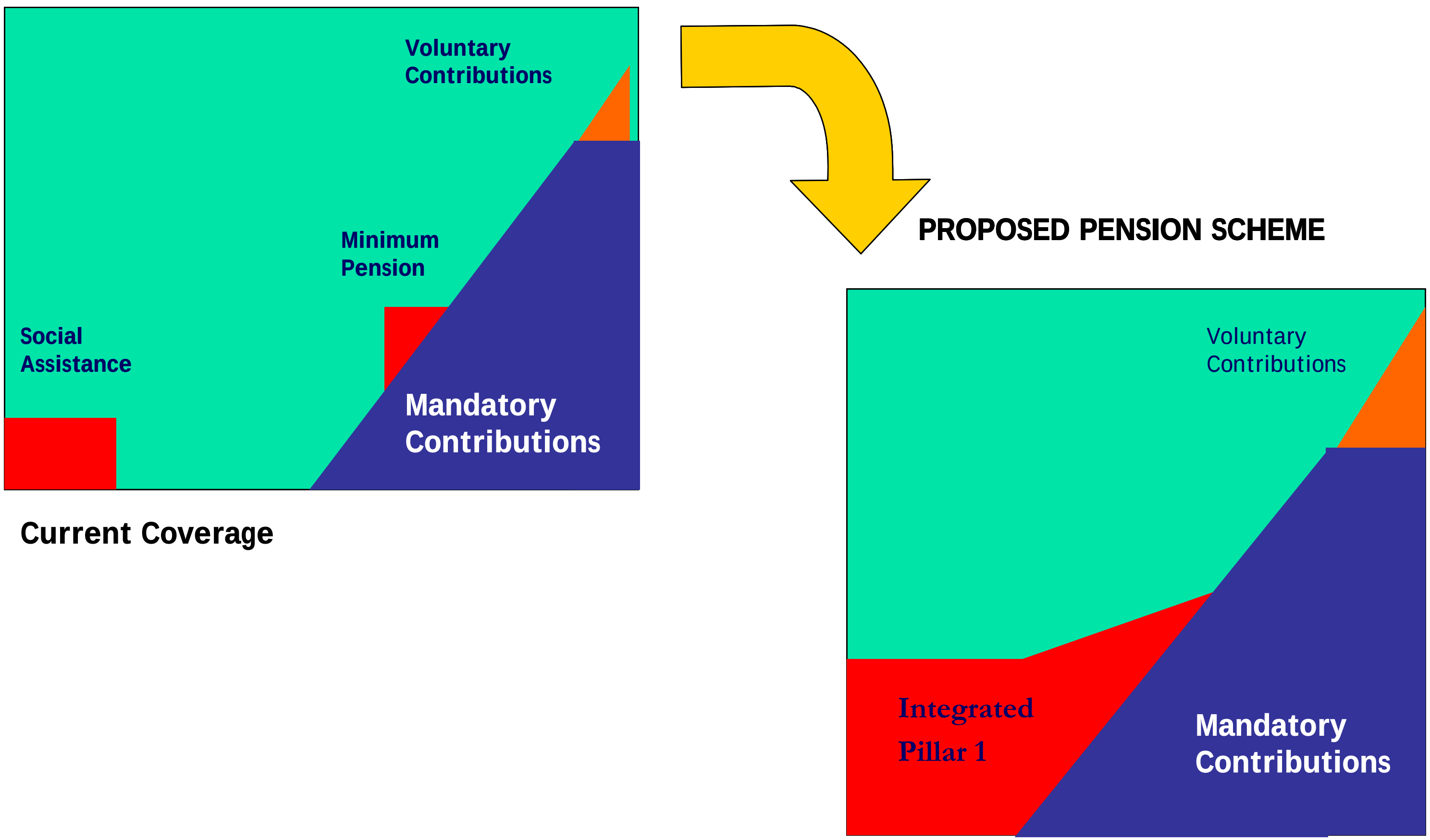
- Minimum 65 years of age
- Belong to the 60% of the population with lowest income
- Minimum of 20 years residence in Chile, including 4 of the 5 years previous to start of benefits

Subsidies of the Solidarity Pension System (SPS)

- For **mothers**: for each birth child a bonus at age 65 equivalent to 12 monthly contributions at minimum wage, plus annual interest of 4% plus inflation
- For **young people** earning less than 1.5 times the minimum wage: 100% subsidy for contributions to a pension fund during the first 24 months of formal employment

Chile's transition to a single, recovery-conditioned pillar 1 pension

CURRENT PENSION SCHEME



Current Coverage

Coverage of the New Pension Scheme

Recall the advantages of universal pensions

- Simple and easy to administer
- Automatic, 100% coverage
- Reach women and rural areas
- Do not stigmatize recipients
- Broad political support
- Avoid disincentive to save for old age
- Avoid disincentive to work in old age

So, what is the downside of universal pensions?

1. They are inequitable, since the wealthy live longer lives than the poor
2. The young should have priority over the old in government expenditure
3. Universal pensions “crowd out” private transfers
4. They are a luxury few countries can afford

1. Universal pensions are inequitable, since the wealthy live longer lives

- The wealthy also pay more taxes
- Life expectancies are averages: some of the poor live long lives; some wealthy die young
- Pension income is known to improve health and increase life expectancy of the elderly poor

2. The young should have priority over the old

- False choice, as budgets are not fixed
- For example, much money is spent on subsidies and tax breaks for contributory Pillar 2 and 3 pensions (examples of South Africa, Australia, Bolivia)
- Pensioners in developing countries live with extended family and share income

3. Universal pensions “crowd out” private transfers

- Each dollar of pension reduces transfers from children by as much as 37 cents
- So what is the implication?
- Is it possible for government to force adult children to care for their parents? After all, household income is not distributed equally: children and productive adults have priority over the old and unproductive

4. Universal pensions are a costly luxury

- Governments spend large sums on minimum pillar 2 pensions and tax relief for contributory pillar 2 and 3 pensions
- Costs can be reduced by increasing age of eligibility or decreasing size of benefit
- Or means tests can be applied *ex ante* or *ex post* (abandoning universality)

Ex ante means tests (social assistance pensions)

- Very common
- High administrative costs
- Large errors of inclusion and exclusion
- Crude targeting, so disincentives for working and saving
- Facilitate corruption

Ex post means tests (recovery-conditioned pensions)

- Very rare – this is an anomaly
- Tax collection relies on ex post tests, so why treat cash benefits differently?
- Control of recovery of pension benefits is easier than control of tax collection, because benefits can be halted whereas tax liabilities continue to grow

Mexico City's universal pension

- Began February 2001 for age 70+
- Monthly "food allowance" equal to ½ of the minimum wage
- Also free health care, public transport
- Universal by October 2002
- Other states now offer similar benefits, but with *ex ante* means tests

Cost of Mexico City's universal pension

- Pension is 11% of Mexico's per capita GDP, but 5.5% of Mexico City's higher per capita income
- Total transfer is 4% of the municipal budget, or 0.25% of Mexico City's GDP
- Politically popular programme

Proposed extension of Mexico City's universal pension to nation

- Campaign promise of Lopez Obrador
- Population older than 70: 3.4% of total
- So transfer = (0.034)(0.11) = 0.00374 or 0.4% of Mexico's GDP
- Subsidies for reformed pillar 2 pension scheme is much more costly

Subsidies for Mexico’s reformed pillar 2 pensions

- Cuota Social (flat sum deposited to each contributor’s account) cost 0.33% of GDP in 1997, projected to fall to 0.2% by 2025
- Guaranteed minimum pension equal to July 1997 minimum wage (cost?)
- “Life switch option” guarantees no loss to those who switched from public PAYGO scheme to system of individual accounts (cost?)

Further information

www.PensionReforms.com

L. Willmore, *Non-contributory Pensions: Bolivia and Antigua in an International Context* (Financiamiento del Desarrollo 167, United Nations, Santiago, Chile, 2006).

L. Willmore, "Universal pensions for developing countries", *World Development* 35:1 (January 2007), pp. 24-51.

Contact information

Larry Willmore, Research Scholar

International Institute for Applied Systems Analysis (IIASA)

A-2361 Laxenburg, Austria

Email: willmore@iiasa.ac.at

http://www.geocities.com/larrywillmore