

Pension watch

Briefings on social protection in older age



Briefing no. 9

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Social protection floors and pension systems:

The role of a “citizen’s pension”

By Charles Knox-Vydmanov

There is increasing recognition of the role of social protection floors in eradicating poverty, reducing inequality and sustaining equitable economic growth in developing countries. Income security in old age is a core element of a social protection floor, yet discussion around extending such floors has been largely separate from parallel debates about the expansion and reform of pension systems. At both national and international levels, pensions and retirement tend to be discussed among a different set of actors from those involved in social protection as a development issue. This briefing makes the link between social protection floors and pension systems, and introduces the concept of a “citizen’s pension” as a particularly relevant approach in developing countries.

Making the link

The last decade has seen growing recognition of the importance of social protection in developing countries beyond “safety nets” focused on short-term emergency relief. Despite strong economic growth in many nations, poverty has remained high and inequality has been rising. Yet a number of countries have bucked this trend by extending comprehensive social protection systems. These experiences have shown two things: first, social protection is essential for tackling poverty and inequality, and ensuring that growth is inclusive; and, secondly, rather than being the preserve of richer economies, meaningful and effective social protection policies are affordable in low-income contexts. Countries such as Brazil and South Africa have been hailed as pioneers in this respect, but they have been joined by lower-income countries such as Bolivia, Nepal and Timor-Leste, which have started to implement pieces of a social protection floor. In addition, the global economic crisis provided a range of examples from countries including Brazil and China of how strong social protection systems both lessened the direct impact of the crisis on individuals and acted as a strong counter-cyclical measure.¹

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The concept of a social protection floor is gaining increasing currency as a way of prioritising the extension and reform of social protection systems. A social protection floor describes a system that guarantees income security and access to basic services throughout the life course. The concept has emerged over the last decade and gained significant recognition, including from the G20, EU, IMF, World Bank, OECD as well as in processes around the Millennium Development Goals and a post-2015 framework.² In June 2012, over 150 countries endorsed a new Recommendation on social protection floors at the International Labour Conference in Geneva.³ For developing countries, the concept is particularly valuable in prioritising the extension of social protection from a rights-based perspective. Social protection and social security systems relate to a broad range of instruments, which have multiple objectives, but the concept of a floor puts focus on realising the right to social security.⁴ Yet the concept is also relevant for more developed countries. Despite significant investment in social protection systems in richer nations, the lens of a social protection floor can help reveal the coverage gaps that often persist.

Box 1: What is a social protection floor?

A social protection floor is a system that guarantees income security and access to basic services across the life course.

The ILO Recommendation 202 concerning “national floors of social protection” calls on countries to establish as quickly as possible social protection floors comprising at least four social security guarantees. These can be summarised as:

1. Access to essential healthcare, including maternity care
2. Basic income security for children (providing access to nutrition, education, care and any other necessary goods and services)
3. Basic income security for persons in active age unable to earn sufficient income (especially in cases of sickness, unemployment, maternity and disability)
4. Basic income security for older persons.

The concept is not prescriptive, and is rooted in the example of countries that have successfully extended a floor. It is also intentionally flexible in its implementation, for example:

- Countries can include a broader range of social security guarantees and some definitions include other services such as housing and water and sanitation.
- What constitutes an adequate minimum floor is defined at the national level, assuring that basic income security allows a life in dignity and is proportional to national thresholds, and healthcare meets the criteria of availability, accessibility, acceptability and quality.
- Social security guarantees can be achieved through a mix of both contributory and non-contributory schemes.

For more detailed background on the social protection floor concept see: ILO Social protection floor for a fair and inclusive globalization, Geneva, ILO, 2011. www.ilo.org/global/publications/books/WCMS_165750/lang-en/index.htm and International Labour Conference, Recommendation 202, Recommendation Concerning National Floors of Social Protection, 2012. www.social-protection.org/gimi/gess/ResShowResource.do?resourceId=31088

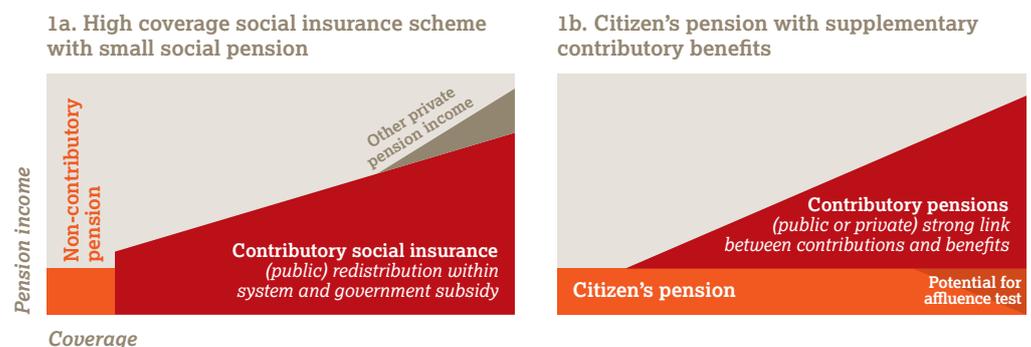
A social protection floor has considerable bearing on the development of pension systems. Guaranteeing a minimum income in old age is a core function of a pension system yet most countries are far from achieving this. Globally, only one in five older people receive a pension and coverage is lowest in developing countries, particularly for women, informal sector workers and people living in rural areas.⁵ The limited success developing countries have had in extending pension coverage stems from a variety of issues, but particularly the fact that most countries have paid inadequate attention to the realisation of the right to social security in old age. Pension systems that have been in place have generally been contributory systems that only cover formal-sector workers with sufficient disposable income to make regular contributions, a population that constitutes a small elite in most developing countries. The increasing recognition of the importance and feasibility of investing in social protection floors can help put focus on the core function of pension systems to guarantee income security to all, where they have historically under-delivered.

Looked at from the other angle, pensions have a distinct and important place in a wider social protection floor. Most people hope and expect to grow old which makes old age a universal human concern. A lack of income security in old age not only has consequences for the dignity and autonomy of older people themselves but also for their families and the networks they are part of, as well as the decisions of future generations of older people. Evidence from countries with relatively comprehensive social protection systems shows that pensions often form the biggest piece of social protection spending, and can have a substantial redistributive role. Pensions are also commonly one of the first steps in the development of a wider floor. Far from competing with other social protection policies, in countries as diverse as Bolivia, Brazil, Nepal, Sweden and a number of Southern African countries, a guarantee of income security in old age has helped pave the way for fulfilment of other social security guarantees outlined in Box 1.⁶

What are the options?

A pension system that guarantees income security in old age can be designed in different ways. As with a wider social protection floor, guaranteeing a basic income security in old age can combine contributory and non-contributory approaches in a variety of ways. This variety is illustrated by the diversity found in more developed countries that have put in place a floor. At one end of the spectrum, some countries such as France, Germany and the United States have been able to provide income security by relying primarily on an expansive social insurance system based on contributory payroll taxes, with a small non-contributory (“social”) pension for those who are left out.⁷ This approach is presented stylistically in Figure 1a. In these systems, insured workers with lower incomes are usually supported via redistribution within the social insurance system, and sometimes through subsidy to the system from the government budget. At the other end of the spectrum, countries such as Australia, Canada, the Netherlands, New Zealand and many Nordic countries have a non-contributory pension that covers most people in old age, with contributory savings as a supplement. This kind of non-contributory pension can be described as a “citizen’s pension” (see Box 2) and is depicted in Figure 1b. The presence of a citizen’s pension provides a cleaner division between contributory and non-contributory schemes, meaning the contributory elements usually have a closer link between contributions and benefits than the approach in Figure 1a. Some citizen’s pensions include an affluence test to reduce benefits for those with other pensions (or exclude them altogether).

Figure 1: Different approaches to guaranteeing income security in old age



Box 2: What is a citizen’s pension?

A “citizen’s pension” is a guaranteed minimum income in old age based on citizenship/residency rather than previous formal contributions. A citizen’s pension must be legislated, adequate and regular.

In February 2012 a meeting of international experts on the issue of income security in old age resulted in significant endorsement of the term as a way to describe a social pension that realises the right to social security in old age.⁸ Many social pensions do not achieve this as a result of low coverage or inadequacy of benefits. The definition of a citizen’s pension also focuses on the outcome of the pension rather than a specific design. A citizen’s pension must ensure a universal entitlement to a secure, minimum income in old age, but this does not rule out designs that may reduce the entitlement for people who already have income security through other means (for example, other pension entitlements).

The word “citizen” is used as it has connotations of entitlement, but a citizen’s pension should be, at the minimum, in line with ILO Recommendation 202 on social protection floors that states countries should provide social security guarantees “to at least all residents and children, as defined in national laws and recommendations”.

For most developing countries, the model of a citizen's pension will be especially relevant for guaranteeing income security in old age. In principle, while either of the models outlined above have the potential to guarantee basic income security in old age, high levels of informality and poverty in developing countries are a major barrier to pension systems based on regular payroll contributions.⁹ Pension systems with high-coverage contributory social insurance have developed in the context of large formal economies, which do not exist in most developing countries. High levels of poverty and vulnerability also rule out the possibility of most individuals making regular contributions for old age. In fact, developing countries over the last 50 years have attempted to implement pension systems based on payroll contributions, and most have failed to extend coverage beyond a minority. Similarly, while contributory schemes for informal sector workers may succeed in providing old age income protection to a few people, positive experiences to date are still few and far between. This is not only due to lack of disposable income but also to the lack of basic administrative infrastructure to collect contributions and maintain individual retirement accounts. This means that putting in place a citizen's pension, upon which contributory benefits can be developed, will be key if these countries hope to make meaningful progress towards universal income security in old age. This is being recognised by an increasing number of developing countries that have put in place non-contributory floors, such as Bolivia, Chile, Kosovo, Nepal, South Africa, Thailand and Timor-Leste.¹⁰

Population ageing clearly provides a challenge to the sustainability of pension systems; however, a citizen's pension is adaptable in this changing context.

First, a non-contributory floor has proved to be an affordable component of a pension system. Within the OECD, New Zealand has a universal non-contributory pension and some of the lowest old-age poverty rates, but the cost of the pension system is also lower than average.¹¹ The picture is similar in poorer countries. Costings by HelpAge International have found that a universal citizen's pension for people over 65 could be implemented for between 0.4 and 1.7 of GDP in 50 low- and middle-income countries surveyed, including rapidly ageing countries such as China and Thailand.¹² Second, there are a number of effective approaches to containing costs over time, including gradually and predictably increasing pension ages in line with life expectancy.

Conclusion

The increasing recognition of the importance of social protection floors can help galvanise greater focus on the central function of pension systems to guarantee a minimum income in old age. Most developing countries have so far under-delivered in this area. The distinct nature of old age and its important place in the development of social protection systems also suggests that this can be a major stepping stone to a broader social protection floor. There are various options for designing a pension system that delivers basic income security, but for most developing countries with high levels of poverty and informality a citizen's pension model will be a priority.

Find out more:

www.pension-watch.net

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3. ILO, *New ILO Recommendation calls for Social Protection Floor for all*, ILO Newsroom, June 2012
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5. Forteza A, Lucchetti L, and Pallares-Mirallas M, "Measuring the Coverage Gap" in Holzmann R, Robalino D A and Takayama N, (eds.), *Closing the Coverage Gap: The Role of Social Pensions and Other Retirement Income Transfers*, World Bank, Washington, 2009
6. See, for example, the case of Sweden in Kokko A, *The Swedish Model*, UNU-WIDER, Helsinki, 2010
7. A social pension is defined as a regular non-contributory income transfer to older people
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9. It should be noted that the spectrum of design options can have implications for a wide range of issues that go beyond the scope of this briefing (for example, perverse incentives and the political economy of systems)
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HelpAge International helps older people claim their rights, challenge discrimination and overcome poverty, so that they can lead dignified, secure, active and healthy lives.

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