Pension watch

Briefings on social protection in older age

Briefing no. 15

Contents

Means testing vs. universal targeting:

Assumptions of efficiency and affordability

By Gibran Cruz-Martinez

Whether social protection benefits should be assigned to all (universal) or kept only for those who meet certain criteria (targeting) remains one of the most contentious questions in social policy research. The purpose of this brief is to revisit two social policy assumptions around basic concerns of efficiency, affordability and sustainability of universal social pensions. Contrary to what many international organisations and scholars have argued, this brief forwards that universal social pensions are economically viable and efficient strategies to produce welfare and alleviate older-age income deprivations. The world clearly has the resources to implement basic social pensions on a global scale; the question is if there is also the political will to do it.

Key messages

- Seventy-nine countries would be economically able to shift from targeted non-contributory pensions to basic universal non-contributory pensions with less than 1.2 per cent of the respective national GDPs.
- Sixteen countries have means-tested/regional-tested non-contributory pensions more expensive than a hypothetical basic universal pension.
- An arbitrary threshold of "economic development" is not a limitation for implementing social pensions. At least 16 countries with a relatively low economic development have successfully implemented social pensions without targeting beneficiaries by means.
- Universal social pensions are politically and economically viable and are efficient strategies to alleviate income poverty.

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The need to implement, restructure and/or develop a progressive taxation system is a generally accepted issue.

Whether social protection benefits should be assigned to all (universal) or kept only for those who meet certain criteria (targeting) remains one of the most contentious questions for social protection policy in low- and middle-income countries (LMICs).

The core of the debate is, generally speaking, in the process – mainly how to target interventions. Over the last three decades, national and international actors have steered towards targeting with a focus on means, with arguments of efficiency and affordability typically at the forefront of justifications (Mkandawire 2005). Several driving forces and arguments have been used to support a generally residual approach to social policy provision. Means testing has been the dominant theory of addressing income poverty reduction globally, and it is this narrative which therefore deserves critique. This brief looks specifically at two assumptions used in support of means testing, using old-age pensions as the object of study. Each assumption is assessed using a combination of literature review and statistical analysis, within a global perspective. The question which is really under scrutiny is whether means testing is really the best approach to alleviate income poverty[1], satisfy social risks and promote wellbeing.

Assumption 1: With an under-developed taxation system, there is no alternative than to target the income poor to alleviate monetary deprivations.

Assumption 2: "Poor" countries should wait to cross the threshold of "economic development" before implementing sustainable social pensions.

These assumptions are not exhaustive – for example, others have argued that means testing suffers from inherent flaws as relates to failing to reach all intended recipients (exclusion errors) and allowing others to benefit who are otherwise not intended to (inclusion errors) (Devereux 2016; Kidd 2015). Similarly, the costs of administering means tested benefits have been shown to often outweigh the benefits of restricting receipt to segments of the population (financial, political, and social). That said, this brief focuses on two broad assumptions which lie at the heart of more mechanical responses to the advocacy of more universal strategies.

Assumption 1: Under-developed taxation systems necessitate means testing

This first assumption revolves around the basic concerns of efficiency and affordability. Taxation is by far one of the predominant funding sources for governments; under-developed tax systems limit their capacity to mobilise and allocate resources for public purposes. Given that tax revenue is expected to be low and insufficient with an under-developed tax system, the simple logic implies that countries must be efficient in the distribution of the resources – i.e. spend less. The constraints faced due to the absence of an institutionalised or adequate tax system are evident and undeniable.

Tax revenues are considerably lower in LMICs than in, say, the European region. This is indeed a significant limitation, which must be addressed and (urgently) taken into account. The need to implement, restructure and/or develop a progressive taxation system is a generally accepted issue. Given the fact that such systems do not (yet) exist in many LMICs, this should not entail that low- and middle-income countries are destined to implement means-tested programmes with "poor benefits" (Sen 1995).

According to the latest HelpAge International database (HelpAge International 2015), 102 countries maintain non-contributory pension programmes. Only 17 of those countries provide universal non-contributory pensions – i.e. pensions which are not restricted by some form of targeting outside age limits. The remaining 85 implement particular forms of targeting (e.g. regional, means-tested, residence, or a combination of them) to identify "truly deserving" older-age individuals. While some within this group come near to universal schemes, they remain outside the category of the latter.

Using the latest age-disaggregated data from the United Nations Population Division (UNPD 2015), the investment needed to implement a universal non-contributory pension is estimated across countries which have already implemented means-

1. The value of the widely used international income poverty line is US$1.90 at 2011 PPP. The use of this threshold to measure poverty or income poverty has received many criticisms over the years, because poverty is much more than income deprivations (Cruz-Martínez 2015a; Cruz-Martínez 2015b) and because a threshold this low limits the ability to actually know the number of people in poverty (Boltvinik 2003).

tested/regional-tested non-contributory pensions. To calculate the investment needed for universal pensions, a modified model of Willmore's (2007) formula is used, adding 5 per cent of the total cost of transfers as administrative cost, previously proposed by Knox-Vydmanov (2011). This formula is given as:

$$Si = rp + Ac$$

Where *Si* is the social investment needed – in percentage points of GDP – to implement a basic universal non-contributory pension, *r* is the ratio of the universal pension to per capita GDP (pension level), *p* is the proportion of the population eligible for pensions (age eligibility), and *Ac* is the administrative cost of the transfer. The data used is from 2015 and allows the inclusion of 79 countries – out of the 85 – which have already implemented means-tested/regional-tested non-contributory pensions.

The age eligibility for actual pensions varies considerably between countries. In order to examine different scenarios, five eligibility ages are considered: 50, 60, 65, 70, and 75. One pension scenario is considered: a pension equivalent to 10 per cent of GDP per capita. Countries considered in this study present diverse economic, social, and political realities; therefore, this pension level should be considered as a "lab test" – arbitrarily assigned – and does not necessarily represent an adequate basic income for all countries.

With less than 1.2 per cent of the respective national GDPs, all 79 countries would be able to shift from targeted non-contributory pensions to universal non-contributory pensions.

Using 75 as the eligibility age may not be ideal, especially for low and middle-income countries where life expectancy is shorter than for high-income countries. Cost concerns typically hamper intervention at lower ages, and it is important to acknowledge these concerns. To solve this issue, Knox-Vydmanov (2011:2) proposed implementing social pensions with higher eligibility ages in order to lower its initial cost, "with the intention to gradually reduce the eligibility age as political support and financial resources grow".

Freeland (2013) argues that the unaffordability argument of universal social protection is (unnecessarily and overly) exaggerated, "affordability is much more closely associated with political will than with fiscal resources". There are other means of finding the fiscal space to promote income security in old age via social pensions – e.g. re-allocation of government spending towards social ends. Governments across the world have budgets and resources allocated to various areas of public and private concern. If we put increasing tax revenues aside and look at uses of existing funds, we can look at what would happen if governments shifted budget resources from other areas of social spending into universal non-contributory pensions.

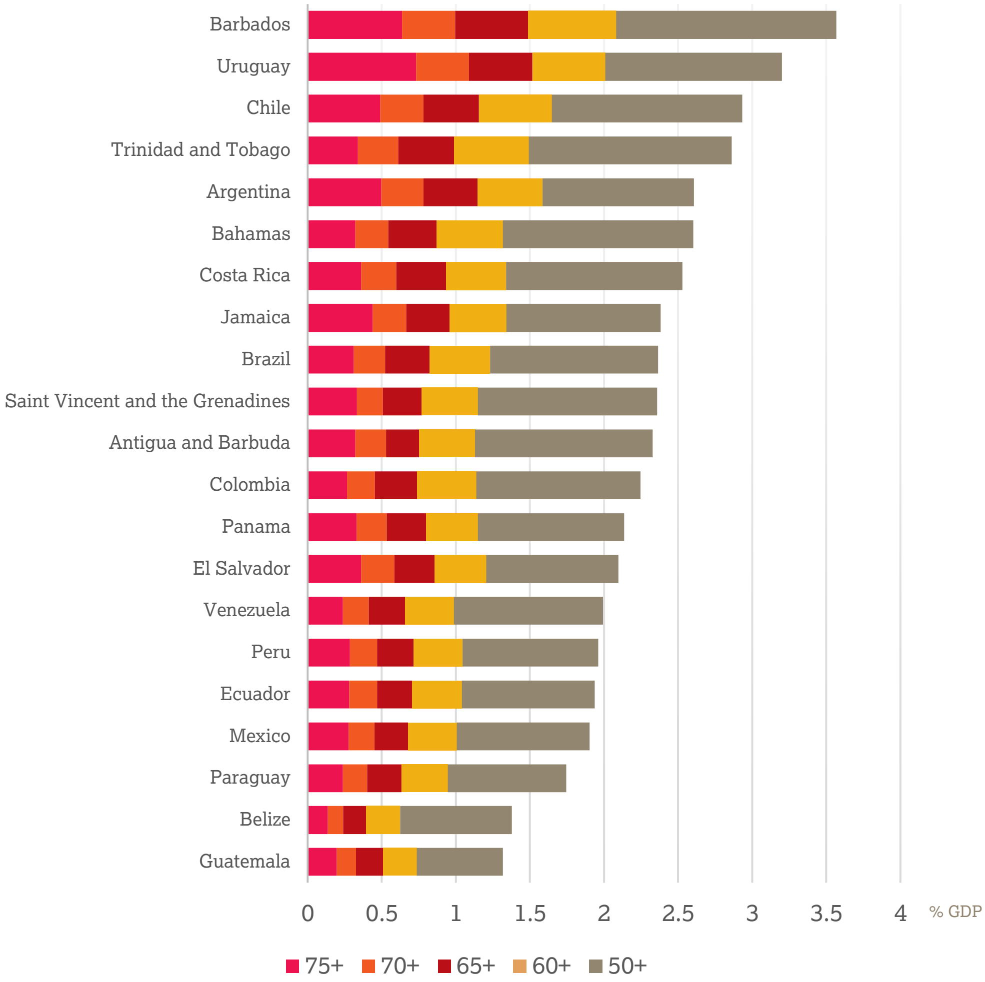
With less than 1.2 per cent of the respective national GDPs, all 79 countries would be able to shift from targeted non-contributory pensions to universal non-contributory pensions with a benefit level of 10 per cent of GDP per capita and with an age of eligibility of 75. This number is increased to 2.4 per cent of GDP if the benefit level is increased to 20 per cent of GDP per capita (not shown here). Figure 1 (page 4) shows the investment needed to implement a universal non-contributory pension for Latin America and the Caribbean. Broadening these results, the same analysis is carried out for the remaining global regions.[2]

According to the latest data from Pension Watch(HelpAge International 2015), 16 countries[3] have tested (means and/or regional), non-contributory pensions more expensive than a hypothetical universal pension with a benefit level of 10 per cent of GDP per capita and with an age of eligibility of 75.

2. Detailed analysis available upon request.

3. Australia, Brazil, Cape Verde, Costa Rica, Denmark, Finland, Lesotho, Maldives, Mozambique, Nepal, Norway, Paraguay, South Africa, Swaziland, Trinidad and Tobago, and Venezuela.

Figure 1: Social investment needed to implement a universal social pension in 21 Latin American and Caribbean countries which have already implemented means-tested and regional-tested non-contributory pensions



Source: Author's calculations based on UNPD, 2015

Here it is useful to take some spending priorities into consideration – for instance, civil servant pensions. Malaysia, for instance, would be able to finance a universal non-contributory pension at 20 per cent GDP per capita and an eligibility age of 60 with the resources used in 2012 on civil servants' pensions – entailing that around 9.2 per cent of the population would benefit directly from this pension system, with around 0.7 per cent of its GDP remaining for other expenditures.[4] Cape Verde, on the other hand, could potentially readjust its civil servants' pension expenditure to subsidise a basic universal pension with the same benefit level as Malaysia and an age of eligibility of 65. The same is true for Kenya (benefit level of 10 per cent of GDP per capita and an age of eligibility of 70), and Mozambique (benefit level of 10 per cent GDP per capita and an age of eligibility of 75).

These, however, are merely illustrative examples and not recommendations per se – this brief does not advocate for the reduction or redistribution of any particular area of government spending. However, the previous examples do illustrate the potential of extending social protection from existing budgetary outlays which may work in tandem with further reallocations and increased savings from efficiency adjustments (e.g. gains made in upgrading administrative systems and contribution collections).[5]

Even with "under-developed" tax systems and other limitations faced by LMICs, resources exist to avoid most, if not all, basic income deprivations which older individuals are particularly exposed to. The key is the political acumen and commitment to determine and develop the means of financing investments into social

4. Author's calculation using data from the World Bank (2013).

5. Governments should remain attentive to adjusting spending towards both productive spending, as well as ensuring that social rights are protected and equalised.

protection rather than a simplistic default solution to excluding all but the most egregious cases of poverty in old age.

Assumption 2: "Poor" countries should wait to cross the threshold of "economic development" before implementing sustainable social pensions

This assumption centres also on the premise of affordability and brings to light the issue of *sustainability* of social protection systems. Based largely on the logic of industrialism and Wagner's Law, a selection of social policy scholarship has forwarded the idea that a certain degree of economic development is requisite to develop an institutionalised social protection system. More simply, surpluses generated by the process of industrialisation provides extra financial resources to increase and sustain the development of social protection programmes. At the same time, the transition from pre-industrial modes of social reproduction facilitates political support by the workforce for such interventions (Esping-Andersen 1990; Scarbrough 2000).

Essentially, as society begins to generate the resources needed to fund social protection systems, the polity increases its support for protection. Von Gliszczynski (2015) argues that development experts and agencies have, following this logic, *assumed* that by reaching a threshold of economic development LMICs will *then* have the capacity to overcome the administrative and financial limitations to implement a sustainable social protection system.

Once countries achieve this (arbitrary) level of economic development, the surpluses produced may then be used to finance social protection. Ostensibly, this appears to be the case; however, this assumption fails to take into account a variety of facts to the contrary. In particular, many countries have gone ahead with social protection in spite of their "disadvantage", and made them work. Lesotho, ranked 151 out of 187 countries in "economic development"[6], provides a useful example to illustrate this point. In 2004, the government introduced an old age pension against the advice of international financial institutions (Freeland 2015; IMF 2016). Initially seen as untenable given its economic situation, the programme "has not only proved affordable, but the Government has been able to substantially increase its share of the domestic budget" (Freeland 2015). Additionally, the relatively high percentage of population over 60 covered (62 per cent) has engendered increasing levels of political support for its continuance and growth.

Lesotho is by no means the exception to the rule; at least 15 additional countries with a relatively low level of economic development – ranked 100 or below in terms of GDP per capita (PPP I$) – have implemented social pensions without means testing.[7] In April 2016, Zanzibar became the newest member of this group of low-income countries with universal pensions. The first government-funded universal pension in East Africa has a pension level of 20,000 Tsh (US$9), pegged to the cost of an essential basket of goods in the archipelago (HelpAge International 2016).

Leaving these 16 instances (plus Zanzibar) to the side, the case for the economic viability and sustainability to implement basic social protection systems in developing countries may also be made using a (basic) counter-factual exercise. Using the economic threshold argument, we can compare how this logic holds up to the universalist Nordic states of Sweden, Norway, Denmark and Finland. To assess the validity of Assumption 2, we look at how many countries have already surpassed the economic development of Nordic countries by the time they implemented their first universal basic security pensions. Put simply, we are looking at whether the assumption that countries must be of a certain level of economic development to institute universal social protection stands up to the test, using the prototypical models of universality.

Output-side real GDP per capita at chained PPP (in 2005 USD) is used as a proxy to operationalise the "economic development" variable.[8] The data used to calculate the Nordic average is comprised of Sweden (1950), Finland (1956), Norway (1957), and

6. GDP per capita on purchasing power parity (PPP) international dollars (I$)

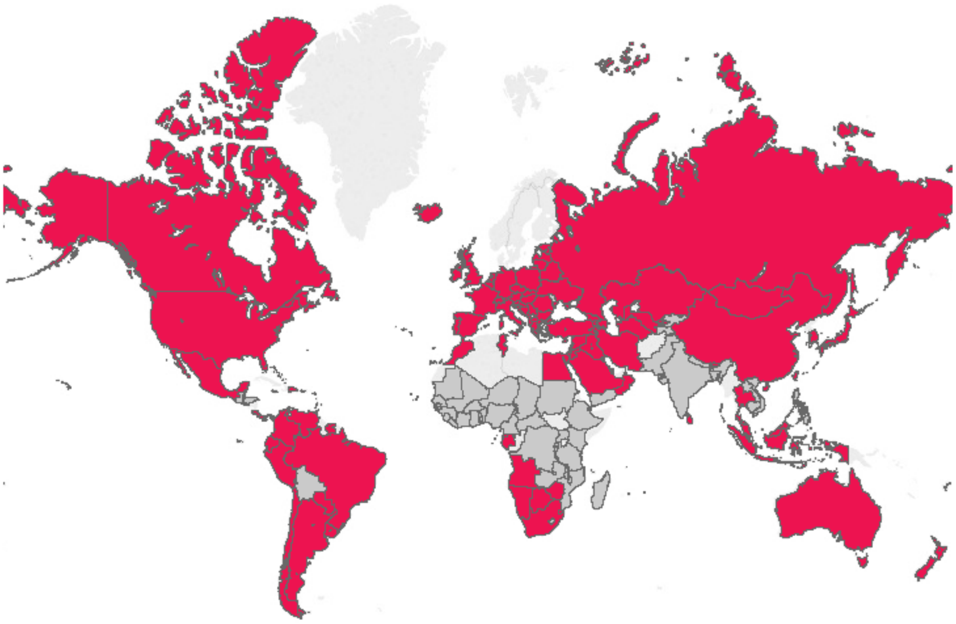
7. Kiribati, Samoa, Timor-Leste, Bolivia, Guyana and Namibia have all implemented universal social pensions. Uganda, Nepal, Papua New Guinea, Tajikistan, Moldova, Vietnam, Uzbekistan, Armenia and Swaziland, have implemented non-contributory pensions with additional targeting besides age (e.g. regional, pensions-tested, or in combination).

8. "Chaining", or chain-linking, enables GDP to be compared statistically over time. The OECD defines chain linking as: "Joining together two indices that overlap in one period by rescaling one of them to make its value equal to that of the other in the same period, thus combining them into single time series. More complex methods may be used to link together indices that overlap by more than period." (ILO et al. 2004).

Denmark (1960).[9] Data comes from the Penn World, Table 8.1 (Feenstra & Inklaar 2015).

Figure 2 illustrates the number of countries with an actual higher level of economic development than Nordic countries had by the time they implemented their first basic universal pensions. Out of 162 countries with available data, 81 (50 per cent) had a higher GDP per capita in 2011 than the Nordic threshold. If the median GDP per capita is used as the Nordic threshold, then an additional country (Colombia) joins the previous 81 cases referenced above.

Figure 2: Countries with a GDP per capita higher than the Nordic average by the time they implemented the first universal basic security pensions (PPP, in 2005 USD).



Note: The map shows in red 81 countries with a GDP per capita (PPP) higher than Sweden, Norway, Denmark and Finland by the time they implemented the first universal basic security pensions. Countries in grey have a GDP per capita below the Nordic countries average. Countries with no available data (and the base countries) are in white.

Source: Author's calculations based on Feenstra et al., (2015)

This is not to say that only 81 countries are economically able to implement non-contributory pensions. The 16 cases mentioned above are by themselves enough evidence to show that exceeding this arbitrary economic development threshold is not a prerequisite to implementing social pension programmes. As mentioned previously, affordability is related more to political will than to fiscal resources. Countries can make social pensions affordable and economically viable through shifting expenditures from other areas or increasing government revenues via taxes (Barrientos 2004); official development assistance can also be considered as the third leg of the "triangle of social protection financing".[10]

Social protection in general, and social pensions in particular, is not only affordable, but its implementation promotes the economic growth which in turn makes social protection programmes even more viable. According to the UK Department for International Development (2006), social protection has a positive impact on economic growth by financing investment in social capital development (e.g. health and education), which in turn fosters complementary development in other areas of the state (DfID 2006). Bolstering this, Mathers and Slater (2014) argues that social protection promotes inclusive growth in low- and middle-income countries by increasing household productivity and local consumption, and by reducing the negative effects of economic and covariate shocks (e.g. financial crises and natural disasters). Indeed, social pensions, from a pragmatic view, represent the conduit by which the state supports households with economic opportunity rather than a drain on society.

9. Sweden is the only country where data does not correspond to the year of implementation of the basic pension.

10. See Ortiz et al. (2015) and Harris (2013) for detailed descriptions and examples on how to increase fiscal space to finance social protection.

Concluding remarks

Universal social pensions are politically and economically viable as well as efficient strategies to alleviate income poverty. This brief has illustrated that universal non-contributory pensions can be implemented successfully in countries with low "economic development", despite arguments to the contrary. However, for those who support the need to attain a certain degree of economic development as a prerequisite for implementing universal social pensions, there are 75 countries that have surpassed this economic threshold and still have not implemented universal social pensions. .

Using five scenarios of age eligibility and two scenarios of benefit level in 79 countries, this brief has illustrated that universal social pensions are affordable. This economic viability, however, must be accompanied with the political will to implement social pensions based on social justice and development. The international community must incentivise capacity building in LMICs to foster the environment for future social protection systems to survive.

Finally, this brief notes that, contrary to the assumption that means testing ought to be the preferred mode of social protection targeting, universal targeting (overall) comes out on top as the social policy of preference – especially and acutely as a first step in the development of social protection systems in LMICs. Challenges to universalism do exist, but they exist somewhat outside the typical counter-arguments for its application. What universal targeting entails for LMICs is a need to reinvent universalism, as we know it from high-income Nordic countries. Governments should look towards implementing basic social protection policies that, with time and support, will be able to evolve into institutionalised and universal welfare systems – not, as neo-liberal thinking has hitherto pressured regional governments to accept, against it.

Pensions, in particular, are a critical area of concern. This is the area of public spending which arguably by far shows the most buy-in and support over time for inclusive approaches, not least because of its capacity to level aggregated individual and group disadvantages. Such pension systems should consist of: basic universal pensions (as a social protection floor for the older population), and earnings-related contributory pensions as complementary schemes to promote employment in the formal sector and increase contributions to the social security system. The world clearly has the resources to implement this on a global scale; the question is if there is also the political will to do it. Social pensions, while often seen as dedicated interventions towards the older-age population, must also be seen in terms of relieving the stress on those households which find their genesis in the beneficiary – i.e. as one of the core (if not the basic) components of social protection strategies.

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HelpAge International is a global network of organisations promoting the right of all older people to lead dignified, healthy and secure lives.

HelpAge International
PO Box 32832
London N1 9ZN, UK

Tel +44 (0)20 7278 7778

info@helpage.org
www.helpage.org

Front page photo of 84-year-old Adila in Colombia by Jonas Wresch/HelpAge International

Written by Gibran Cruz-Martinez
Research Fellow, HelpAge International; Visiting Fellow, Institute of Latin American Studies, University of London
Edited by Daniel Horn

The author gratefully acknowledges extremely valuable feedback and edits from Daniel Horn. Charles Knox-Vydmanov, Flavia Galvani, Aderonke Gbadamosi and Alice Livingstone provided much appreciated comments on earlier drafts of this paper. The findings and views expressed herein are those of the author and do not necessarily reflect the official or implicit views of HelpAge International or its network and associated organisations.

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ISBN 978-1-910743-13-3