Closing the Coverage Gap: The Role of Social Pensions in Middle Income Countries

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## Exchange Rates on October 24, 2008

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Abstract

There are a variety of reasons for increasing recognition by the policymakers that social pensions can play an important role in achieving coverage and poverty-mitigation objectives of the social security system. The contributory, formal-employment related schemes leave significant segment uncovered, or inadequately covered. There has also been greater acceptance of the rights of the elderly to basic minimum income, particularly in middle and high income countries. This chapter provides case studies of the role of social pensions in closing the coverage gap in five middle-income counties (MICs) – Brazil, Chile, Indonesia, Mauritius, and South Africa. These are chosen for the diversity in their location, population-size, income levels, and government commitment and capacities to implement social security system in general, and social pensions in particular. Except for Indonesia, other MICs have instituted or have credible plans to institute fairly extensive social pension systems. As a result, the issue of the coverage gap, i.e. the difference between the potential and actual number of elderly receiving non-contributory budgetary assistance, is being addressed satisfactorily. There is however need for much further research on the broader economic and social impacts of different designs and implementation strategies of social pensions in the MICs.
I. Introduction

Provision of adequate retirement security, including mitigating poverty among the aged, has been a major challenge in most countries of the world. Not only is the proportion of the elderly expected to increase significantly, but each person will need to be supported for a longer period\(^1\). As consumption of society’s health care resources typically rises disproportionately with individual and population ageing, larger resources are needed to finance retirement (Fuchs, 1998).

For managing retirement financing risks, a multi-tier framework under which an individual obtains income from multiple-sources with differing risk and other characteristics, has been proposed by The World Bank (Holzmann and Heinz, 2005). Among the five pillars proposed by the World Bank, PAYG (Pay-As-You-Go), a mandatory savings schemes, and occupational pension plans have received the most attention.

There is however increasing recognition that with the changing labor markets, particularly the decreasing role of formal employer-employee relationships on a long-term basis, which has been the foundation of earnings-related formal pensions schemes, that non-earnings related and non-contributory schemes can help in reaching a large segment of the population unable to make sufficient contributions to formal schemes\(^2\). Such schemes can also provide a part of the retirement financing for those who may be significantly affected by adverse macro-economic environment, such as low interest rates at the time of retirement leading to low annuity income streams from a given capital sum. High capital market volatility could also adversely impact on retirement accumulations, and income from financial investments during retirement\(^3\). Some of the MICs face the added challenge of coping with high incidence of HIV and AIDS, which have serious impact on pension and health expenditure.

The non-contributory schemes or social pensions have been in existence for some time, but they have usually not been integrated with other tiers, or been subjected to as much rigorous research as the contributory schemes.

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\(^1\) The proportion of the world population aged 60 and above is expected to double from 10.3% in 2005 (numbering 673 million) to 21.8 % in 2050 (numbering 2006 million); while the global life expectancy at birth is expected to increase from 67.2 in 2005-10 to 75.4 in 2045-50 (United Nations, 2006)

\(^2\) Zero Pillar in the World Bank’s classification.

\(^3\) The ongoing global financial turmoil is an emphatic reminder of this possibility. The global stock market capitalization fell from US$ 60,874.4 billion by end 2007 to US$ 42,766.9 billion by end September, 2007, a fall of 29.7 percent (http://www.world-exchanges.org/WFE/home.asp?menu=395&nav=ie). As the markets have fallen since then, the erosion of market capitalization is likely to be even larger. This has adverse impact on the replacement rate which may be obtained from the contributory schemes, whose assets are invested in the capital markets.
It is in the above context that this chapter analyzes the role of social pensions in closing the coverage gap in selected Middle Income Countries (MICs). In 2006, there were 96 countries with total population of 3.1 billion (48 percent of total world population), and PPP GNI of US$ 24,613 billion (37 percent of the world’s PPP GNI) (World Bank, 2008a). In 2005, life expectancy at birth in the MICs was 68 years for men, and 73 years for women (World Bank, 2008a).

This chapter contains the case studies of five MICs, namely - Brazil, Chile, Indonesia, Mauritius and South Africa. The sample countries are from Africa, Asia and Latin America, providing wide geographical coverage. They also vary in per capita income (ranging from US$ 3728 in Indonesia to US$ 13886 in Chile; population (ranging from 1.3 million in Mauritius to 226 million in Indonesia); share of population above 65 (ranging from 4.5 percent in South Africa to 8.5 percent in Chile); total fertility rate (ranging from 1.96 in Chile to 2.73 in South Africa); and life expectancy at birth (ranging from 51 in South Africa to 78 in Chile) (Table 1).

(Insert Table 1 Here)

Consistent with the MICs as a group, the life expectancy for females in the sample countries exceeds that of males by substantial margin in the sample countries (Table 1). Thus, in Brazil women’s life expectancy is 7.3 years higher than that of males. As women usually have a lower exposure to labor force as a group, but on the average earn less than men, the contributory pensions schemes, particularly of the DC types, will expose them to longevity and inflation risks in retirement. The non-contributory pensions could therefore be an important instrument for addressing the gender issues.

The above countries are selected to be representative of the wide variety of social pension practices in the MICs. Countries such as Chile and South Africa have also been influential in shaping the pension policies, particularly in their respective regions. It is therefore hoped that these case studies will have implications for the social pension policies of the other MICs.

The rest of the paper is organized as follows. Section II provides an overview of pension systems of the sample countries with particular emphasis on the non-contributory

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4 The World Bank divided economies according to 2007 GNI per capita, using the World Bank Atlas method. The groups are: low income, $935 or less; lower middle income, $936 - $3,705; upper middle income, $3,706 - $11,455; and high income, $11,456 or more (United Nations, 2006).

5 It may be argued that life expectancy is positively correlated with income. As low income people may die early, social pensions may end up benefitting the upper income groups. While this may be the case on the average, non-contributory schemes are still needed because such correlation may not necessarily apply at an individual level. Moreover, in many of the middle-income countries, economic insecurity is high even among the middle class. With the global growth expected to slow significantly in 2009 (IMF, 2008), such insecurity will become even greater.
schemes. Section III analyzes the available evidence on the role of social pensions in closing the coverage gap. The final section provides the concluding observations.

II. Pension Systems: An Overview

This section provides an overview of the pension systems in the five sample countries. Each country does have more than one pillar for providing pensions. The role of non-contributory social pensions however varies considerably across countries.

Brazil

Brazil is divided in five major geographical regions, comprising 26 states in addition to the Federal district. The Federal Constitution of 1988 established the broad concept of social security, involving social insurance, health care, and social assistance.

The contribution to a scheme is not a condition of entitlement to benefits for health care and social assistance. Brazil has also expanded the coverage of social security through the category of Special Insured Persons (SIP), which includes farmers and others in the informal sector. Contributions in respect of the rural workers are a percentage of marketed agricultural produce rather than wages (as is the case for formal sector workers). In practice, many low-income rural workers are therefore able to receive benefits provided their previous activity was recognized, without individual contributions.

Brazil has also introduced flexible rules favoring the inclusion of other categories of contributors, especially voluntary contributors (for example, women without their own income performing household tasks) and independent workers (mostly self-employed persons).

In Brazil, social insurance, together with health care and social assistance, is based on the pay-as-you-go (PAYG) financial system which embodies the principle of solidarity between generations.

Private-sector workers belong to a social insurance scheme called the General Social Security Scheme (Regime Geral de Previdência Social—RGPS). Some specific groups of public servants also belong to the RGPS. Most public servants, and military personnel, are covered by their own social security schemes, with their own regulations and

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6 The information about the main features of the Brazilian social security system is from Ansliiero and Paiva (2008) and Savoia (2006).
specific features. Recent reforms however have reduced the differences between these schemes and the RGPS.

The RGPS is a public contributory scheme with compulsory membership for all employed workers not covered by their own social security scheme. Persons with low incomes who are not covered by contributory social security schemes receive benefits under a Continuous Welfare Benefit pension (Benefício de Prestação Continuada — BPC), which is currently set at the same level as the minimum monthly wage.

The new Federal Constitution established qualifying conditions for men and women in rural areas, reduced the minimum age for the award of retirement benefits to age 60 (men) or age 55 (women), and established a uniform minimum welfare benefit for all insured persons (rural workers had previously received old-age pensions at levels of up to 50 per cent of the minimum wage and their spouses and/or children had received survivor pensions limited to 30 per cent of the benefit paid or payable to the deceased).

Brazil also has non-contributory social assistance programmes, primarily for poverty relief. These programmes and the RGPS (except for state government employees) are managed by the INSS (The National Institute for Social Security). Brazil thus has a multi-pillar system, with an important role for the social pensions.

Chile

Chile’s 1981 pension reforms have been extensively discussed in social security literature and have had considerable influence in policy debates (Mesa-Lago, 2008). The reforms resulted in a switch from a Pay-As-You-Go (PAYGO) system to a privately managed contribution system, in which contributions were made only by the employees. After nearly three decades of experience with the pension system, there has been a reassessment, particularly with respect to coverage and adequacy. As at end-2007, total assets of pension funds were US$111 billion (68 percent of GDP). The current global economic crisis, with falling stock markets and currency values will adversely impact the medium-term real rate of return, reducing the replacement rate obtained from these balances.

In March 2006, the newly elected President Bachelet set up a Presidential Advisory Council on Pension Reform under the chairmanship of Mario Marcel to evaluate the existing pension system. Subsequently, a new Pension Act was enacted in March 2008.

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The basic tenet of Chile’s system is that each worker is responsible for financing his own pensions. Under the 1981 reforms, the State provided assistance to those unable to fund their retirements. This was undertaken in two ways:

(i) **PASIS**: A publicly funded means-tested social assistance pension was provided to the poorest aged members, irrespective of their contribution history. The Government limited the number of PASIS pensions granted in order to control expenditure; thus there was always a waiting list to access these pensions.

(ii) **MPG**: A Minimum Pension Guarantee was provided to all individuals who had contributed to the system for at least 20 years (specifically, made at least 240 contributions) but had not accumulated enough to achieve a minimum pension. This guarantee applied only when a member did not have enough accumulations to enable him to draw down a pre-specified minimum benefit. The State simply topped up the members’ accounts by an adequate amount. The minimum pension was set at approximately three-fourths of Chile’s minimum wage or one-fourth of the average wage.

There were other covert guarantees provided by the State. If an AFP went bankrupt, the Pension Funds belonging to the members did not suffer, instead, the worker simply transferred them to another AFP.

In the case of the bankruptcy of an Insurance Company, the State guaranteed 100 percent of the minimum pension guaranteed by the State, plus 75 percent of the difference between the pension the pensioner was receiving and the Minimum Pension Guaranteed by the State, with a ceiling of 45 UF per month.

The pension system in Chile has seen a number of changes since its inception to improve coverage, adequacy, and equity (Mesa-Lago, 2008; Asher and Vasudevan, 2008).

The new pension system is based on the three-tiered structure. Tier I is a government-financed social safety net called the Solidarity Pillar. Tier II involves mandatory contributions with measures designed to increase the coverage of the labor force. Tier III involves additional voluntary savings. The incremental annual cost is projected to be 1.1 percent of GDP.

The basic design of the contributory second pillar will remain unchanged, although its scope will be widened to cover currently excluded workers (Asher and Vasudevan, 2008).

**The Solidarity Pillar**: A new System of Solidarity Pensions (SPS) will replace the existing PASIS scheme and the Minimum Pension Guarantee provided by the government. The
aim of creating this pillar is to provide universal pension coverage to all Chileans and to minimize old-age poverty by supporting those with lower capacities of contributing towards their pensions.

The SPS will benefit men and women aged 65 years and above, belonging to the poorest 60 percent of the population. Additionally, in order to be eligible for SPS benefits, the applicant should have lived 20 years in Chile, in particular during the five years preceding the application.

The main benefits under the SPS include the Universal Basic Pension (PBU) and the Solidarity Contribution (APS). From July 1, 2008, all persons who did not contribute to the system, and have no other source of pension, will receive a minimum solidarity pension if eligible for SPS. Such persons will receive a Basic Pension amounting to CLP 60,000 (USD111) per month, which will increase to CLP 75,000 (USD 139) by 2009.

Persons who have some contributory pension and are eligible under SPS, will receive a ‘complementary’ top up that will decline as the member’s own pension increases, and will finally cease when the self-financed contributory pension reaches the Maximum Pension with Solidarity Contribution (PMAS).

The PMAS will be set at CLP 60,000 (USD 111) per month in 2008, and will rise to CLP 200,000 (USD371) per month by 2012. PMAS values during the five-year transition period are shown in table 23. The rate of ‘withdrawal’ of the complementary top up is designed in such a way that total pension always increases in response to higher contributory effort.

**Expected Outcomes:** The groups that would benefit most from this proposal include workers with low contribution densities; the workers with relatively volatile income, such as seasonal workers and independent workers; the people who have dedicated an important part of their active lives to unremunerated home work such as the care of children, old people or disabled relatives; less-educated workers; and old people with very low pensions.

According to projections of the Commission, when the system would start operating in 2008, 510 thousand people or about 40 percent of the population over 65 years will receive a Basic Solidarity pension. This represents an increase of 100 thousand people over the current number of beneficiaries of Assistance Pensions. By the fifth year of operation, it is expected that 60 percent of the poorest in Chile or over 1 million persons will benefit from the Scheme.

The Scheme’s other advantage is that by creating a link between the smallest marginal contributions and additional pensions received, it maintains the incentive to make regular contributions. The Solidarity pension is integrated smoothly into the contributory scheme.
Thus if workers contribute regularly to their individual pension accounts, the contributing pillar assures a worthy pension to them. If for some reason they do not contribute at all or do so infrequently, then they are supported by the solidarity pillar that not only guarantees a basic pension, but also assures higher pensions based on their contributions.

The Voluntary Pillar: The main component of the voluntary pillar of the present pension system is the Ahorro Voluntary Previsional (APV), which came into effect on 1 March 2002 under law Nº 19,768. APV balances have grown at an annualized rate of 35 percent between 2002 and 2005, reaching US$1.9 million in December 2005. Unfortunately, utilization of APV tends to be highly correlated with income: 26.1 percent of high-income contributors to the AFP system made APV contributions in 2005, but only 2.7 percent of low-income contributors used APV. In fact, voluntary pension-related savings are also a very small fraction of total financial voluntary savings, currently accounting for only 5.2 percent of the total.

Thus the most important reform proposed by the committee is a measure to make the APV more inclusive: currently only those independent workers who are affiliated to an AFP are permitted to contribute to an APV, this restriction is to be removed to allow access to all independent workers.

Additional proposals for strengthening the voluntary pillar can be grouped under two categories: fiscal incentives to promote additional voluntary savings within the current system; and provisions for new voluntary savings plans.

The reform proposes to (i) exempt low income individuals from paying tax (at 3 percent) on early withdrawals from their voluntary accounts and (ii) abolish taxes on commissions paid to voluntary savings account providers. Further, legislation will be put in place to ensure that funds left in voluntary pension savings accounts form a part of inheritance estates.

The reform bill also includes a provision for new employer sponsored voluntary pension plans, known as Ahorro Previsional Voluntario Colectivo (APVC), which would collect contributions from both employers and employees. Employers would be permitted to set up more than one APVC plan, if it is approved by a majority of workers. The APVC plans would be non-discriminatory, implying that the plans must be open, in equal conditions, to all the workers of the company who wish to participate in them.

The changes proposed to the APV are expected to sustain the high rates of growth demonstrated by this product since its creation, and also enable larger proportion of workers to take advantage of its benefits. The creation of a legal framework for a collective employer-employee plan such as the APVC will provide an important alternate form of saving and broaden the Chilean pension market.
Indonesia

Since Independence in 1945, Indonesia has made significant progress in economic and human development (Arifianto, 2006). Indonesia has a diverse set of social security arrangements, but the coverage remains low, and professionalism with which provident and pension funds are managed could be improved greatly. Traditionally, extended family has been relied upon for old-age support.

The private sector workers in Indonesia are covered under Jamsostek programs which provide life insurance, work accident protection, provident fund, and health maintenance plans. Firms with 10 employees or more are covered. Jamsostek is a state monopoly. Only about 20 percent of the workers are covered by Jamsostek schemes (Arifianto, 2006). The compliance by eligible employers is low at around 25 percent.

The previous Indonesian Social Security law (law No. 3/1992) stipulated that except for provident fund contributions of 5.7 percent of wages which are shared by employer (3.7 percent) and employee (2.0 percent), premiums for other programs are paid only by the employer. The total contribution varies between 9.24 and 13.74 percent, of which workers pay only 2.0 percent.

The provident fund system under Jamsostek is a defined contribution system paying lump sum at retirement. In practice, the provident fund is not portable as accumulated balances can be withdrawn at termination of employment, under some conditions.

Any employer can establish a private pension plan. These plans had membership of no more than 2 million persons in 2005. The plans for employees of financial institutions, which have relatively high per member balances, are supervised by the Ministry of Finance. The assets of employers’ funds have been the largest among the social security institutions, at around 2.5 percent of GDP. The total pension assets are only around 4.5 percent of GDP, of which Jamsostek accounts for about a quarter. For a mandatory national provident fund, this is quite low, suggesting severe design and implementation challenges (Asher, 2002).

The civil servants are covered under the PT Taspen, another state monopoly. Civil servants receive defined benefit pensions for life, and death benefits paid to survivors. The retirement age is 56 years, quite low as compared to life expectancy.

The contribution rate for employees is 4.75 percent of the basic salary. This covers little less than a quarter of the total benefits, with the rest provided from the
budget. The contributions of those who leave before retirement are not returned, reducing labor mobility. The pensions of civil servants are indexed to salary increases for active civil servants.

The military has separate defined benefit scheme, administered by Asabri. Its provisions are similar to those for PT Taspen.

Thus, in Indonesia, the civil servants and armed forces are protected against longevity and inflation risks, but private sector employees are not. Lack of professionalism in performing functions by Jamsostek has prevented members from fully benefiting from the scheme. This and the inherent limitations of the provident fund scheme have meant very low replacement rate.

On 28 September 2004, the Indonesian House of Representatives (Dewan Perwakilan Rakyat, or DPR) endorsed the law on the National Social Security System (Undang-Undang Sistem Jaminan Sosial Nasional, or SJSN). The law became a public law (Law No. 40/2004) on 19 October, 2004. It has however not been implemented as of October 2008.

The Law aims to apply the social insurance principle on a comprehensive basis. It covers health insurance, work injury, old-age (provident fund), pensions, and death benefits. The law further stipulates that the government will develop social assistance programmes.

The mandatory savings component, and building up of pension reserves could reach between 10 and 20% of GDP over time. The law aims to create a social fund for the informal sector for pensions and health insurance. Estimating the financial (and fiscal) implications of the devise to reach the informal sector workers would be especially challenging.

There are however concerns that there is a serious mismatch between the objectives of the law on one hand and financial, institutional, organizational and regulatory capacities to implement the law on the other. The impact of this law on employment growth also needs to be considered. Arifianto (2006) has estimated that the total contribution rate of between 22.54 and 23.75 percent of wages will be required to achieve the objectives of the new law; but the law has identified contribution rates equivalent to 6.24-7.75 percent of wages. It is not clear where the balance is likely to be obtained.

Relatively large proportion of the retirement needs are being financed through family and community support in an informal manner.

Mauritius
Mauritius has provided elderly with non-contributory age pensions on a universal basis since the late 1950s. It is thus one of the few countries to make extensive use of the social pensions.

The National Pensions Scheme in Mauritius, governed by the National Pensions Act 1976, includes both contributory and non-contributory elements. In addition, under the National Savings Act of 1995, National savings Fund (NSF) was set up. The contribution rate is 2.5 percent of the basic salary (subject to a ceiling). The contributions are credited into the account of each individual. The benefit is paid as a lumpsum when a person retires.

Mauritius has also instituted a means-tested social assistance scheme, which may be paid in cash or in kind, as a safety net for those who qualify. The assistance varies according to the needs of the household. There are also other minor social welfare schemes. Mauritius has more than 60 schemes of social protection, which appears to be too numerous for a total population of only 1.3 million.

The Mauritian Government has promulgated the Protection of Elderly Persons Act 2005 which provides a legal and administrative framework to ensure that adequate protection is available to older people (be it physical, verbal, mental, emotional or material). The Senior Citizens Council, set up in 1985, has registered more than 600 Senior Citizens Associations. Thus, there is an active civil society which participates and monitors the welfare of the senior citizens.

The contributory benefits are payable only to (or on behalf of) those persons who have contributed to the National Pensions Fund (NPF). The contributory pensions include old-age, invalidity, widow and orphan pensions in addition to industrial injury allowances.

The contributory retirement pension begins at age 60, and provides a pension equivalent to one-third of average earnings after 40 years of contributions to employees contributing at a standard rate of 9 percent. A pension of one-half of the earnings is paid to those contributing at the higher rate of 13.5 percent of basic income, subject to a ceiling.

The non-contributory benefits, on the other hand, are entirely financed by the government and are payable to every citizen under some residency conditions. The non-contributory benefits include Basic Retirement Pension (BRP), Basic Widow’s Pension (BWP), Basic Invalid’s Pension (BIP), Basic Orphan’s Pension and Guardian’s Allowance (BOP), and Child’s Allowance.

The BRP however is the main non-contributory social pension scheme. It is payable to all citizens aged 60 years and over. It is thus universal. The BRP benefits are equivalent to

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8 The retirement age will be raised to 65 years over a period of 10 years, beginning from August 2008.
about 18 percent of average earnings. As on July 1, 2008, the BRP was MUR 2,802 per month for persons between 60 and 89 years; MUR 8,335 for those between 90 and 99 years; and MUR 9,461 for those above 100 years. The pension thus increases with age, and is paid until the person dies. Thus, the state bears the longevity risk. The BRP for severely handicapped is MUR 1,766 per month.

In 2005/06, the government expenditure on social security and welfare amounted to MUR 11.4 billion, equivalent to 23.3 percent of total government expenditure, and 5.8 percent of GDP (Republic of Mauritius, Ministry of Finance, 2007).

According to the same source, the amount distributed under the BRP was MUR 4.1 billion in 2005/06, equivalent to 36.0 percent of total expenditure on social security and welfare. The corresponding proportion for BWP was 6.0 percent; BIP was 8.7 percent; and social assistance scheme was 3.1 percent. The share of contributory pensions in total expenditure was 4.8 percent.

Mauritius faces a demographic challenge. The number of working-age persons per retiree is projected to decrease from 7 in 2000 to 2.3 by 2040 (Willmore, 2006). By 2030, the proportion of the total voters who are over 60 years of age is expected to reach around one-third (Willmore, 2006). The elderly vote will therefore be influential in affecting election outcomes.

The official projections are that the beneficiaries for the BRP will increase by about 80 percent, from 126 thousand (nearly 10 percent of the total population) in June 2006 to 228 thousand by 2021. The costs of BRP will increase by about 75 percent from MUR 4.1 billion in 2005/06 to MUR 7.3 billion in 2020/21.

**South Africa**

The first country in Africa to institute a state pension, the first parliamentary proposal for an old age pension grant was made in 1922. The age criteria was 65 and above to receive a pension. In 1937 eligibility for women to receive pensions for both races was reduced to 60 years. Now it is 60 years for women and 65 years for men.

In the 1944 Union of South Africa pension was extended to all South Africans. However, black South Africans received a lower pension than the value transferred to the white and colored residents. There were also differentials in the higher rate paid to black South Africans in urban areas compared with the lower rate in rural areas. With the end of the apartheid, government in 1994 pension was finally equalized across all citizens.

South Africa currently has fairly comprehensive programmes for social security, with important role assigned to social assistance or social pensions. The old-age pensions (OAP) are means-tested. Men aged 65 and above, and women aged 60 and above are
eligible. In early 2008, the OAP amount was up to ZAR 870 a month for a single pensioner; while married couples received double the amount. There is a provision for grant-in-aid allowance (ZAR 180 a month) for those receiving OAP who require the full-time attendance of another person as the result of a mental or physical condition. The OAP is non-contributory, with the government bearing the total cost.

Family allowances cover low income persons who have children younger than age 18. The total cost of this program is also borne by the government.

The employer-based pension plans may be DB or DC types. The private pension plans are regulated by The Financial Services Board (FSB). At March 31, 2007, the FSB supervised about 13,000 registered retirement funds (South Africa, 2007). As at end-2005, the total assets of retirement funds were ZAR 1,284 billion (84.3 percent of GDP); while the total membership was 9.3 million (slightly more than half of the labor force) (South Africa, 2007).

South Africa thus has one of the largest private retirement industries among the MICs. In the current global economic crisis, as stock markets and currency values\(^9\) decline such large accumulated financial assets are likely to reduce the medium-term real rate of return on these balances. This in turn, will adversely impact on the replacement rate obtained from these balances.

There have been two noteworthy initiatives by the South African government in recent years. The first is the Older Persons Act, 2006 (Act 13 of 2006). Its main objectives are to promote the well-being and participation of older persons in the South African society.

The second initiative is more substantive and will fundamentally change the current social security system once instituted. The initial proposals are contained in a document released by the Minister of Finance on 23 February 2007, titled “Social Security and Pension Reform: A Second Discussion”. An Inter-Ministerial Task Force has been set up to restructure the current social security system. The new system is likely to contain four broad elements. First, non-contributory social assistance to deal with poverty; second, a contributory social insurance component to cover retirement (partially), unemployment, disability and injury; third, a mandatory retirement savings, designed to provide additional replacement rate, and increase national savings; and fourth, a voluntary savings and insurance arrangement. For very low-income earners, the introduction of a wage subsidy will seek to offset the mandatory contribution.

The policymakers hope that the mandatory participation could improve coverage and efficiency of the system by generating the appropriate scale of operations. The role of

current retirement pension funds, where participation is voluntary, will need to be reconciled with the mandatory participation feature of the proposals.

In the 2008 State of the Nation address, the South African President emphasized the need for consultation and planning before these proposals involving complex technical and transitional issues are actually implemented. It appears that for a variety of reasons, including the current global economic crisis, the original 2010 target date for implementation is unlikely to be met.

III. Social Pensions and the Coverage Gap

The discussion in the previous section has suggested that except for Indonesia, there are either substantive social pensions schemes in place in the sample countries, or as in Chile, they are being instituted. These differences are reflected in the coverage of the social security schemes.

The coverage may be measured in different ways (Rofman and Leonardo, 2006). For active workers, the coverage may be measured as the ratio of contributors to economically active individuals; as the ratio of contributors to employed workers; or the ratio of contributors to wage earners. As social pensions are provided to the aged, the ratio of pension recipients to individuals over 65 (or 60), disaggregated by those receiving social pensions, and those receiving other type of pensions, is appropriate. In many low middle-income countries, the ratio of aged individuals residing in households with pension recipients to individuals over the age of 65 (or 60) could provide better social measure of the old-age income security.

Not all sample countries have such detailed coverage ratios monitored regularly. The discussion below therefore provides only a broad indication of the coverage in these countries.

In Brazil, there is a significant divide between the participation of men and women, whites and blacks in the formal employment sector and as contributors to the social security program (Ansiliero and Paiva, 2008). The coverage ratio therefore may vary considerably among different groups and regions of the country.

Table 2 provides the coverage of the employed population in Brazil in 2006. The data suggest that 64 percent of the 52 million workers were covered by social protection; while 36 percent were not covered in 2006. Nearly 10 percent of the covered were Special Insured Persons (RGPS). The non-contributing beneficiaries amounted to only 1.6 percent of the total.

Brazil’s use of non-contributory schemes to provide pension benefits is reflected in the significant difference in the coverage rates based on contributors to employed persons
(48 percent in 2002) on the one hand, and beneficiaries to population aged 65+ ratio (90 percent for men and 84 percent for women in 2002) (Rofman and Lucchetti, 2006).

In Chile, in 2003, the ratio of contributors to the pension system to economically active population was 59 percent, a decline from 62 percent in 1990. Similar declines have been observed for contributors to wage earners ratios (Rofman and Lucchetti, 2006). The pension beneficiaries to population aged 65+ ratio declined from 73 percent in 1990 to 63 percent in 2003. The decline was particularly sharp among women, from 67 percent to 56 percent (Rofman and Lucchetti, 2006).

As Chile’s pension system is largely based on contributions by the members, the declining coverage underlines the need for non-contributory social pensions. As discussed in Section II, Chile’s reforms are designed to move the system in this direction. As Chile’s pension reform has been quite influential in shaping the pension policies in Latin America and elsewhere, its recognition that contributory systems, while essential, need to be supplemented with non-contributory elements such as social pensions, is significant.

Indonesia has minimal social pension provision. Its fiscal and government service delivery capacities are also not currently conducive to extensive use of social pensions as is the case in the other sample countries. The 2004 SJSN Law does envisage government paying the social insurance premiums for those who are unable to pay. However, implementing this provision will be difficult as it involves fiscal and transaction costs. As the Law is yet to be implemented, its immediate impact will be limited.

Mauritius has had a fairly long history of universal social pensions. As noted in Section II, about 10 percent of the total population received BRP in June 2006. In addition, 71 thousand (5.5 percent of total population) received other types of pensions and child allowances. The social pension coverage is therefore quite high. The challenge for Mauritius would be to sustain this coverage, and provide adequate pensions in the future.

South Africa’s experience with social pensions has been studied extensively (Palacios and Sluchynsky, 2006; Patel and Triegaardt, 2008; Barrientos, 2003). The studies almost uniformly show a significant reduction in poverty rates for the elderly. Thus, Barrientos (2003) estimates that among the sampled households in South Africa, the poverty headcount would be 1.9 percentage points higher without social pensions.

The reduction is attributed to high coverage and large benefits relative to incomes, particularly for the black population (Palacios and Sluchynsky, 2006). In 2007, 2.2 million beneficiaries received social pensions, and 33 thousand benefitted from the grants-in-aid program (Patel and Triegaardt, 2008). There is also evidence that social pensions and other non-contributory income-support programs have also had a positive impact on access by women (Patel and Triegaardt, 2008). There are however concerns whether
South Africa will be able to sustain such ambitious social pensions and related programs in the medium-term due to fiscal affordability, and institutional capacities.

The above discussion suggests that social pensions have the potential to substantially improve the coverage of the social security systems, provided there is political commitment and reasonably effective delivery mechanisms. The manner in which this is achieved has however differed among the sample countries, reflecting their history, and social and economic structures. Coverage however is only one of the important objectives of a pensions system. Adequacy, sustainability, and equity are also relevant.

IV. Concluding Remarks

This chapter has provided case studies of the role of social pensions in closing the coverage gap in five middle-income counties (MICs) – Brazil, Chile, Indonesia, Mauritius, and South Africa. These have been chosen for the diversity in their location, population-size, income levels, and government commitment and capacities to implement social security system in general, and social pensions in particular. Except for Indonesia, the other sample countries have instituted or are planning to institute extensive non-contributory social pensions, financed through the budget as an integral part of their social security systems. In Indonesia, the 2004 SJSN Law, which envisages comprehensive social insurance based social security system, has not yet been implemented. However, in the Law there is provision for government to share the social insurance premiums for the low-income individuals in both formal and informal sectors. If implemented, this would constitute the equivalent of social pensions in Indonesia.

The sample countries (with the exception of Indonesia) have been able to address the coverage gap for the elderly population. There is however much more country-specific research required for better understanding of economic and social impacts of different designs and implementation strategies concerning social pensions. The political economy aspects also require further investigation. The current global economic crisis underscores the need for a multi-tier system in general, and for the non-contributory social pensions and related programs in particular. This will require simultaneous reforms designed to sustain high growth, improve fiscal health, and more effective delivery of government services.

Table 1: Macroeconomic and Demographic Indicators in the sample MICs, 2007
<table>
<thead>
<tr>
<th></th>
<th>Brazil</th>
<th>Chile</th>
<th>Indonesia</th>
<th>Mauritius</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP, PPP (current international $ - billions)</td>
<td>1833.6</td>
<td>230.4</td>
<td>841.1</td>
<td>14.2</td>
<td>463.3</td>
</tr>
<tr>
<td>GDP per capita, PPP (current international $)</td>
<td>9569.9</td>
<td>13885.7</td>
<td>3727.9</td>
<td>11278.4</td>
<td>9736.4</td>
</tr>
<tr>
<td>Population, total (million)</td>
<td>191.6</td>
<td>16.6</td>
<td>225.6</td>
<td>1.3</td>
<td>47.6</td>
</tr>
<tr>
<td>Population ages 65 and above (% of total)</td>
<td>6.4</td>
<td>8.5</td>
<td>5.8</td>
<td>6.8</td>
<td>4.5</td>
</tr>
<tr>
<td>Fertility rate, total (births per woman)</td>
<td>2.26</td>
<td>1.96</td>
<td>2.23</td>
<td>1.99</td>
<td>2.73</td>
</tr>
<tr>
<td>Life expectancy at birth, total (years)</td>
<td>72.1</td>
<td>78.3</td>
<td>68.2</td>
<td>73.2</td>
<td>50.7</td>
</tr>
<tr>
<td>Life expectancy at birth, female (years)</td>
<td>75.8</td>
<td>81.4</td>
<td>70.0</td>
<td>76.6</td>
<td>52.5</td>
</tr>
<tr>
<td>Life expectancy at birth, male (years)</td>
<td>68.5</td>
<td>75.4</td>
<td>66.4</td>
<td>69.9</td>
<td>49.0</td>
</tr>
</tbody>
</table>

Note: Data for Fertility rate and Life Expectancies pertain to 2006. Figures are rounded to one decimal place.
Table 2: Social protection of the employed population between 16 and 59 years of age * (2006)

<table>
<thead>
<tr>
<th>Categories</th>
<th>Number of workers</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>RGPS Contributors (A)</td>
<td>36,931,870</td>
<td>45.6</td>
</tr>
<tr>
<td>RPPS Contributors (B)</td>
<td>5,637,203</td>
<td>7.0</td>
</tr>
<tr>
<td>Military</td>
<td>271,169</td>
<td>0.3</td>
</tr>
<tr>
<td>Public servants</td>
<td>5,366,034</td>
<td>6.6</td>
</tr>
<tr>
<td>Special Insured Persons ** (RGPS) (C)</td>
<td>8,049,773</td>
<td>9.9</td>
</tr>
<tr>
<td>Non-contributors (D)</td>
<td>30,319,474</td>
<td>37.5</td>
</tr>
<tr>
<td><strong>Total (E = A + B + C + D)</strong></td>
<td>80,938,320</td>
<td>100.0</td>
</tr>
<tr>
<td>Non-contributing beneficiaries *** (F)</td>
<td>1,285,007</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>Workers covered by social protection</strong> (A+B+C+F)</td>
<td>51,903,853</td>
<td>64.1</td>
</tr>
<tr>
<td><strong>Workers without social protection</strong> (D-F)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>with incomes of less than 1 minimum wage</em></td>
<td>13,277,493</td>
<td>16.4</td>
</tr>
<tr>
<td><em>with incomes equal to or greater than 1 minimum wage</em></td>
<td>15,429,425</td>
<td>19.1</td>
</tr>
<tr>
<td><em>with unknown incomes</em></td>
<td>327,549</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Notes:
* Regardless of income criteria.
** Inhabitants of rural areas working in agriculture in the following categories: unregistered, self-employed, producing for their own consumption, building for their own use, and unremunerated.
*** Employed workers (excluding special insured persons) who while not contributing receive welfare benefit.

Source: Ansiliero and Paiva (2008)
References


