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## **ADB Working Paper Series**

### **What is the Role of Social Pensions in Asia?**

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**Abstract**

Rapid population ageing and economic transformation in Asia raise the policy challenge of ensuring income security in old age. There is growing interest among policymakers in the potential role of noncontributory transfers as an instrument to address a variety of policy challenges, including old age poverty and vulnerability, rapid population ageing, the effects of migration on intergenerational family support structures, and the effects of informality on social protection systems. The main objective of this paper is to explore the potential role of social pensions and other noncontributory schemes in Asia, informed by insights from theory and international experience. The paper identifies alternative forms of providing income security in old age, including social pensions. It also examines the welfare effects of adopting alternative social pension designs, especially around two key policy nodes: the comparative advantages of social assistance and social pensions, and the integration of noncontributory transfers within advanced contributory pension schemes.

**JEL Classification: H55, I38, J14, J32, O17**

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## 1. INTRODUCTION

In developing countries there is growing interest among policymakers in the potential role of noncontributory transfers as an instrument to address a variety of policy challenges, including old age poverty and vulnerability, rapid population ageing, the effects of migration on intergenerational family support structures, and the effects of informality on social protection systems. Noncontributory schemes addressing old age poverty and vulnerability include social assistance, which provides assistance to households in poverty, including older persons; and social pension schemes, which consist of self-standing schemes focused explicitly on older groups. The main objective of this paper is to explore the potential role of social pensions and other noncontributory schemes in addressing old age poverty and vulnerability in Asia, informed by insights from theory and international experience. The paper identifies alternative forms of providing income security in old age, including social pensions, and provides a discussion on the welfare effects of adopting alternative policy options.

Noncontributory schemes, including social pensions, describe a variety of tax-financed public programs providing regular cash transfers to older people,<sup>1</sup> with the objective of providing a measure of income security in old age. They are referred to as noncontributory pensions because entitlements are not based on employment or on a record of payroll contributions. Instead, they are granted solely on citizens meeting age and need requirements. It can be questioned whether noncontributory pensions and social pensions are pensions in the technical sense of the term. In common with contributory pension schemes, noncontributory pensions address longevity risk—the risk that we may outlive our resources. In contrast to contributory pension schemes, social pensions rarely require beneficiaries to withdraw from the labor force, and they are not associated with retirement.<sup>2</sup> The term "social pension" emphasizes the common ground existing between these programs and social assistance.<sup>3</sup>

Most countries have some form of assistance to older people who are in need but who are not entitled to benefits from existing pension schemes. In contrast, social pensions are rare in developing countries. Interestingly, there are clusters of developing countries with large-scale social pensions. Countries in the Southern Cone of Latin America constitute one cluster (See Box 1 below). Countries in southern Africa—Botswana, Lesotho, Namibia, South Africa, and Swaziland—are another cluster. There is another cluster of countries with social pensions in south Asia, including Bangladesh, India, and Nepal. Outside these clusters, social pensions are scarce.<sup>4</sup> There has been a strong push for social pensions in developing countries in the last decade, within and outside the above-mentioned clusters (Bertranou, Solorio, and Van Ginneken 2002; Holzman, Robalino, and Takayama 2009: 111–18).

In developed countries with advanced social protection systems, demographic pressure on pension schemes combined with labor market liberalization have focused attention on basic

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<sup>1</sup> Social pensions often cover people with disabilities and sometimes widows, too. This paper will focus only on old age social pensions, but much of this discussion applies to all social pensions.

<sup>2</sup> The largest cross-country comparative study of pension schemes done to date finds that their most common feature is that they ensure retirement (Mulligan and Sala-i-Martin 1999).

<sup>3</sup> The paper does not cover micropensions, microsaving instruments facilitating voluntary saving for old age. Existing micropension schemes in South Asia typically fail to cover longevity risks (Rutherford 2008; Shankar and Asher 2011: 1–21).

<sup>4</sup> HelpAge International's Pension Watch has an interactive map with information on countries with social pensions. This is available at <http://www.pension-watch.net/country-fact-file/>

pension provision, sometimes referred to as "first-pillar pensions."<sup>5</sup> In developing countries, noncontributory schemes are proposed in a variety of contexts. In low-income countries, noncontributory pensions are being actively considered as an instrument to address poverty.<sup>6</sup> Social pensions, and other categorical transfers, have advantages where capacity to formulate and deliver poverty reduction programs is low and financial resources are limited. In middle-income countries with high incidence of informality, contributory pension schemes often cover a fraction of the labor force at best, and the space for expanding the coverage through social insurance schemes is limited. Noncontributory pensions provide a strong policy option to extend pension coverage to informal workers.<sup>7</sup> Noncontributory schemes are also relevant in contexts where rapid industrialization and urbanization stimulate migration but undermine the economic sustainability of rural areas and traditional forms of family intergenerational support.<sup>8</sup> Noncontributory schemes are also important in contexts where rapid population ageing provides a narrow time window in which to set in place appropriate institutions. Compared to countries such as France or the United Kingdom (UK), many Asian countries will have a relatively short time to establish schemes providing income support for older people, and social pensions have the advantage over contributory schemes in that they can be put in place rapidly.<sup>9</sup> Noncontributory schemes are particularly relevant to old age poverty and vulnerability reduction in developing countries, but are potentially appropriate in the context of a range of policy challenges.

This paper will begin by identifying and characterizing existing provision. There is diversity in old age income support policies, including social pensions, within Asia. In part this is a reflection of the presence of high-income, middle-income, and low-income countries. Several countries have introduced noncontributory schemes, or strengthened and expanded existing provision focused on older groups.

This will provide the empirical context in which to discuss and apply the main findings from the theoretical literature on noncontributory schemes and poverty reduction. Noncontributory pensions generate positive welfare effects in reducing poverty and vulnerability among older people and their households. Redistribution to poorer groups improves overall welfare. At the same time, this redistribution has implications for incentives—the incentive to work and save among beneficiaries—and the disincentives arising from tax financing. The analysis will focus on assessing the social welfare effects of noncontributory schemes by examining the main trade-offs existing between poverty reduction, incentives, and public budgets.

The overview of existing practice in Asia suggests two key policy nodes along a continuum of policies to address old age poverty and vulnerability. The first node can be found around the relative advantages of social assistance and social pensions as alternative approaches to address old age poverty. This is particularly relevant to low-income countries and middle-income countries without well-developed contributory pension schemes and high informality. A second policy node can be found around the relationship and links existing between noncontributory and contributory pension schemes. This policy node is especially relevant to high- and middle-income countries in Asia with large-scale contributory pension schemes. A

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<sup>5</sup> Pearson and Whitehouse find that social pensions "are the dominant part of retirement income systems in many high income countries" (Pearson and Whitehouse 2009: 99–110).

<sup>6</sup> For a study of the potential role of social pensions in Africa, see Kakwani and Subbarao (2007: 987–1,008).

<sup>7</sup> This applies especially to Latin American countries (Bertranou, Solorio, and van Ginneken 2002) and South Asia (Alam and Barrientos 2010).

<sup>8</sup> These processes explain the emergence of noncontributory pensions in Brazil and South Africa, although in South Africa the situation was exacerbated by the spatial segregation under apartheid (Barrientos 2008: 169–92). These processes are at work in the People's Republic of China (PRC) (Benjamin, Brandt, and Fan 2003).

<sup>9</sup> The speed of demographic change poses significant policy challenges for developing countries. A doubling of the share of a country's population aged 65 and over, from 7% to 14%, took 115 years in France, 69 years in the United States, and 45 years in the UK, but it will take 19 years in Singapore, 21 years in Brazil, and 26 years in the PRC (Kinsella and He 2009).

focus on these two policy nodes will help organize the discussion in a way that is manageable within a short paper.

The paper is divided as follows: Section 1 examines existing noncontributory pension provision in Asia. Section 2 discusses the main policy gaps, and the objectives and design of noncontributory schemes. Section 3 explores the main trade-offs existing between poverty reduction, incentives to work and save, and the size of required budgets. The section argues that these three are the key parameters throwing light on the welfare effects of noncontributory schemes. Section 4 explores the relative advantages of social assistance and self-standing social pension schemes in tackling old age poverty and vulnerability. Section 5 briefly discusses the issues involved in seeking to combine noncontributory and contributory pension programs. The final section summarizes the main points and concludes.

### **Box 1: Noncontributory Schemes in Latin America**

Pension schemes can be traced back to the 1920s for countries in the Southern Cone of Latin America—Argentina, Chile, Uruguay, and Brazil. They consisted mainly of occupational social insurance funds covering specific groups of workers in transport, the public sector, and the armed forces. In the 1950s and 1960s, many governments consolidated these funds and brought them under public control. Expectations among policymakers and researchers in the region assumed a European-style social insurance dynamic, with gradual expansion of coverage in line with economic development; little attention was paid to noncontributory schemes. The acute crisis in the 1980s in the region, referred to as the "lost decade," led to structural pension reform, replacing pay-as-you-go social insurance funds with individual retirement plans in 12 countries. Advocates of the reforms claimed that re-establishing a direct link between contributions and benefits would encourage informal workers to join pension schemes. In this regard at least, the reforms proved unsuccessful. The share of workers actively contributing to pension schemes, whether reformed or unreformed, has continued to decline in most countries. At the turn of the century, and taking the region as a whole, one in every two workers depended on informal employment and only one in every four actively contributed to a pension scheme.

Attention shifted to noncontributory schemes as a means of extending the pension coverage of the older population. A spectrum of initiatives has been implemented. Brazil, an example of a country that rejected structural pension reform in favor of parametric reforms, introduced two noncontributory pension schemes in the early 1990s, covering informal workers in rural areas and older people in poverty nationwide. Brazil has the highest coverage rate of the older population among Latin American countries, at around 84%. In countries with reformed pension schemes, such as Chile, efforts have been made to improve the incentives for workers to join pension schemes by providing public subsidies to low-income contributors. Lower-middle-income countries have made use of revenues from natural resources to introduce social pensions, categorical in the case of Bolivia and means tested in the case of Ecuador. Social assistance programs secure a minimum income to older people in households in extreme poverty.

What lessons for Asia can be drawn from the Latin American experience? One is that expanding coverage of contributory schemes can be achieved only through substantial public subsidies. A second lesson is that noncontributory schemes provide a more effective instrument to raise pension receipt among older groups, but in countries with high levels of informality this approach could reinforce segmentation in social protection. A third lesson, and perhaps the most significant, is that labor market liberalization, ageing, and the rising costs of post-school education can combine to reduce the capacity to save for old age, especially among younger groups.



It will be helpful to begin by taking stock of noncontributory pension programs in Asia. Table 1 provides summary information on noncontributory pension programs and related policies addressing old age poverty and vulnerability for selected countries in Asia. The country information in the table is not intended to be comprehensive; all transition countries in Asia have well-developed transfer schemes, which in different ways cover older people, but of these the table only includes information for Kyrgyzstan. Along similar lines, several countries have contributory pension schemes with wide coverage of the older population, which include guaranteed minimum pensions, but of these only Japan and the Republic of Korea are included in the table. The table is intended to inform on the spectrum of approaches adopted and to support a basic typology highlighting key features of existing programs.

**Table 1: Summary Information on Social Pensions and Social Assistance Covering Older People for Selected Countries in Asia**

Country	Design	Coverage	Benefits	Reforms
Japan	Several noncontributory pension schemes: full-time housewives, disabled, low-income earners exempt from paying contributions	Housewives (10.50 million), low-income old age qualified (5.84 million)	Equivalent to the basic pension in contributory pension schemes	Discussions around a categorical pension financed from a rise in consumption tax
Republic of Korea	Minimum Living Standards Scheme (2000) income maintenance benefits to poor households including older people  2007 National Pension Scheme includes a means tested noncontributory basic old age pension, financed from contributory scheme	60% of population aged 65 and over; coverage exceeds the share of older people in poverty but it is less than a categorical pension	Around 5% of National Pension Scheme affiliates' monthly earnings; less than 20% of national poverty line	2007 Basic Old-Age Pension Law is being implemented
Nepal	Social pension introduced in 1995, categorical for older people, selective for widows; implemented by public agencies	Citizens aged 70 and poor widows aged 60 and over; covers 76% of eligible population	Flat rate age-related benefits: monthly \$2.00–\$6.50 (NRs150–NRs500); in 2007 scheme absorbed 0.23% of GDP	2009, lower age of entitlement (from 75 to 70) and improved benefit levels
Thailand	Old Age Allowance initiated in 1993 and gradually expanded, more recently in April 2009	Citizens aged 60 and over not receiving a government pension; covers 6 million or 80% of older population; 0.01% of GDP	Flat rate monthly benefit is \$14 (B500) (around 34% of poverty line)	Planned upgrade of benefit as resources permit; benefit rising with age
India	National Old Age Pension Scheme (1995) Social assistance pensions for elderly, widows, and disabled; persons with a below poverty line card; managed and supplemented by states	Varies by state but national estimates suggest it covers 7%-10% of older people (5 million) and widows (3 million).	Flat rate but varies due to co-contribution by state government; 2005–2006 monthly basic benefit was \$4.5 (Rs2,200); central government budget is 0.04% of GDP	Recent expansion of coverage to all below poverty line card holders and upgrade in benefit level
Bangladesh	Old Age Allowance and Distressed Widows Allowance introduced in 1997/98, community selection and implementation; people aged 57 and over; means tested	Fixed number of beneficiaries per village (15 oldest and poorest in each ward); in 2006 1.6 million beneficiaries	Flat rate monthly benefits \$4 (Tk300); scheme absorbs 0.12 of GDP	
Philippines	Legislation introduced in 2010, social pensions for people aged 70 and over; means tested.		Flat rate monthly benefit is \$11 (P500).	

Country	Design	Coverage	Benefits	Reforms
Viet Nam	Social pension introduced in 2004, people aged 60 and over; elderly living alone in poor households, or with spouse needing care; elderly 80 and over not receiving pension or social allowance	Qualification age is 80 years; 119,068 (2009) in first category and 691,120 (2009) in second category; or 10% of elderly and 50% of social allowance recipients	Monthly benefit is \$6 (D180,000).	In 2004 age of eligibility was 85, then 60 plus included in 2006, and reformed in 2007
People's Republic of China	Five Guarantees Scheme: Original Dibao and Wubao provide assistance to elderly, disabled, children with Three No's (no supporting family members, no ability to work, no source of income); means tested	Dibao covered 22.0 million in 2008 and has been extended to rural areas (around 46.0 million additional beneficiaries); Wubao covered 5.3 million (5% of older people in rural areas) in 2007	Variable rate benefits: Dibao provides cash and in-kind benefits of around \$20 per month on average; Wubao benefits are mainly in kind	2009 experimental rural pension scheme to achieve full nationwide coverage by 2020; basic noncontributory component (\$8 is central government basic rate)
Kyrgyzstan	Monthly Social Benefit Scheme provides assistance to vulnerable categories: older people without pensions, disabled children, and orphans		2009: 62,100 beneficiaries (all categories); 1.2% of state budget; benefit is \$15 for older people	
Sri Lanka	Public Welfare Assistance (Mahajanadara 1939); means tested benefit to destitute persons, including older people; means tested; also Samurdhi (1995) national poverty alleviation program	Approximately 60% of beneficiaries are elderly people	\$1–\$4 per month	

GDP = Gross Domestic Product

Sources: Pension Watch at <http://www.pension-watch.net/country-fact-file/>; Barrientos, Niño-Zarazúa, and Maitrot 2010; Dutta, Howes, and Murgai 2010: 63–70; Moon 2009; Takayama 2009: 111–18; Weber 2010.

At one end of the policy spectrum, countries may opt to address old age income security through generalist **social assistance programs** providing support for all individuals and households in poverty, independently of the age of beneficiaries. In the table this is the approach adopted for Sri Lanka, where, outside contributory pension schemes, older people in poverty are covered by social assistance programs (Mahajanadara and Samurdhi) that are open to all groups in need. In practice, older people make up the majority of beneficiaries of the Public Welfare Assistance Scheme. This also applied to the schemes under the Five Guarantees in the People's Republic of China (PRC), which targeted people in need independently of age. In 1999 the Dibao program covering individuals in poverty in urban areas reached around 2.4 million beneficiaries, consisting mainly of older and disabled people. The rapid rise in unemployment at the turn of the decade meant the program expanded to around 22 million beneficiaries in 2002.

The next type of program includes **social assistance programs which explicitly target older people, often through a separate program component**. Kyrgyzstan is a case in point. Social assistance consists of two transfer programs—a Unified Monthly Benefit, which is paid to households in poverty and with children; and a Monthly Social Benefit, which is paid to specified categories of people recognized as facing acute vulnerability. The Monthly Social Benefit covers, among other people, children with disabilities and older people without a pension. Typically, the Unified Monthly Benefit is means tested and paid for a fixed period of time, while the Monthly Social Benefit is more generous, categorical, and paid for extended periods without review.

The next type of program is distinguished by the fact that transfers to older people stand as a separate program from the rest of social assistance. They are more properly referred to as social pensions. Eligibility includes a categorical requirement, age or disability, and a means test. In the table, Bangladesh, India, the Philippines, and Viet Nam provide examples of **selective social pension schemes**.<sup>10</sup> The programs have a minimum age of qualification—57 in Bangladesh and 80 in Viet Nam. Means tests ensure that only older people in poverty or extreme poverty are entitled to transfers. In India, the extension of entitlement to all older people with a Below Poverty Line card relies on the beneficiary selection process of the Public Food Distribution Program to identify pension beneficiaries. In Bangladesh, the identification of beneficiaries is done by community committees. These programs are supported by legislation and are delivered by public agencies.

The next type of program includes **categorical pension programs** providing benefits to all citizens above a particular age. They are usually referred to as "universal" social pensions. In the table, Nepal is the only country in Asia with a categorical pension program. It was introduced in 1995 and provides a monthly transfer to all citizens aged 70 and over (the age of entitlement was initially 75 but was lowered in 2009). Selective social pensions are also available in Nepal to widows in poverty from age 60.

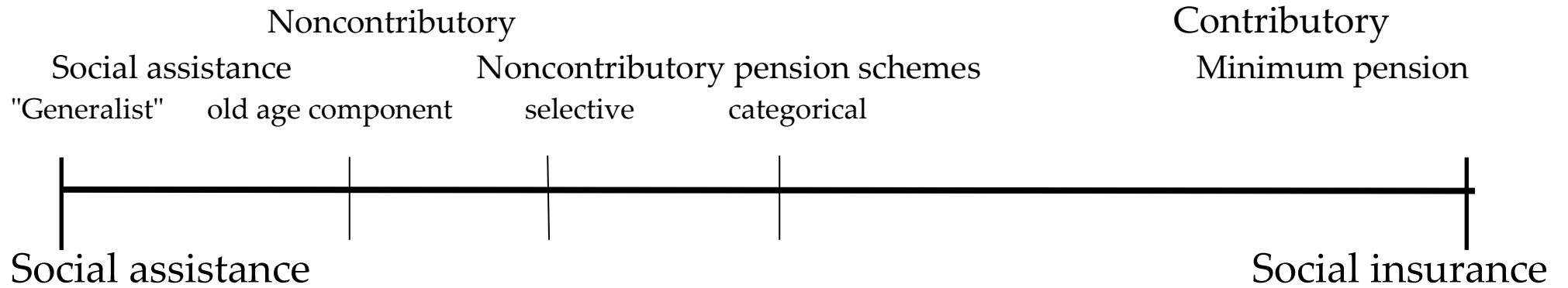
The final type of program consists of **guaranteed minimum pensions**. They are normally components of contributory pension schemes providing a basic level of benefit to affiliates with low contribution density, i.e., with significant gaps in contributions throughout their working lives. They differ from noncontributory pension schemes in as far as they require some contribution record, however minimal. They are mainly financed by a mix of contributions and government subsidies. In countries with well-developed contributory pension schemes, such as Japan and the Republic of Korea in the table, guaranteed minimum pensions interact with social pensions in significant ways. The conditions for eligibility, benefit levels, and entitlement periods of the two types of pension schemes need to be designed with considerable care to ensure that incentives for workers to contribute remain sufficiently strong.

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<sup>10</sup> In the literature, the terminology often makes reference to "means tested" social pensions as distinct from "universal" social pensions. In this text, the terms "selective" versus "categorical" social pensions are employed instead. They are more accurate descriptors.

In summary, it is possible to identify four main types of noncontributory programs providing transfers to older people: “generalist” social assistance programs covering all households in poverty, social assistance programs with an explicit or separate old age component, selective social pension programs, and categorical noncontributory pension programs. The typology is presented in summary form in Figure 1. This typology is useful for several reasons. Firstly, it demonstrates the variety of policy options available to countries in Asia, and the fact that social pensions lie within a continuum of possible ways of supporting older people. Secondly, it helps identify the main features of social pensions and related instruments, and the main issues related to their design and implementation. And thirdly, it facilitates a discussion of institutional change over time.

Figure 1: Policy Options for Old Age Income Security



Source: Author

## 2. NEEDS, OBJECTIVES, AND DESIGN

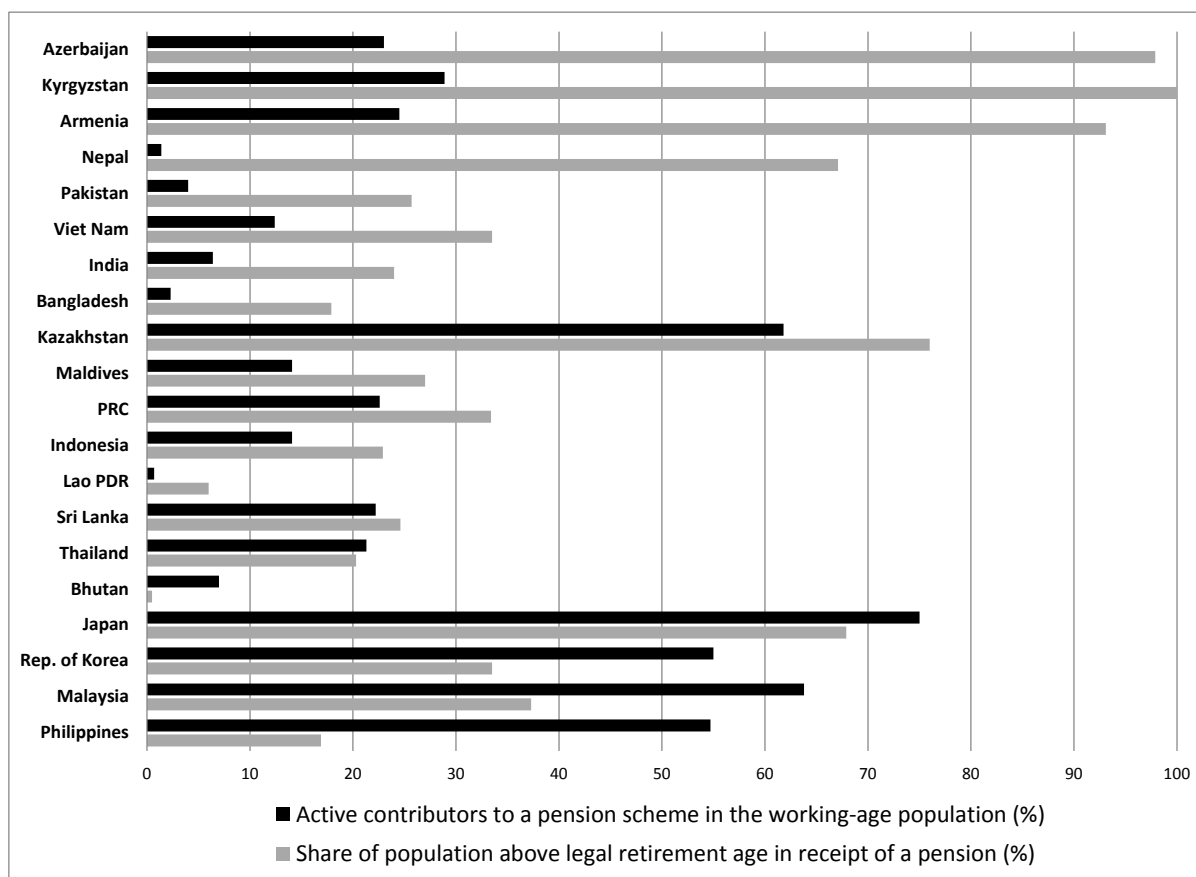
The main objective of this section is to trace the links that exist between perceived policy needs, alternative objectives for noncontributory schemes, and program design. In response to perceived policy needs and gaps, noncontributory schemes can be associated with a variety of objectives, with implications for scheme design.

Addressing old age poverty and vulnerability is a primary objective in social pensions based on social assistance. Old age is commonly associated with a decline in productive capacity. Studies on the relationship between age and earnings, for example, suggest it has an inverted U shape, so that mean earnings of workers decline towards the end of their working lives. Several potential explanations for this apparent decline in earnings and productivity with age have been put forward in the literature. They include the impact from depreciation in acquired human capital over time, or the effects of age discrimination in employment and earnings. Non-labor income is also likely to decline in old age, as the wealth accumulated during working lives is drawn down in retirement. The decline in productive capacity and employment opportunities in old age suggests that the probability of experiencing poverty rises in later age. However, the empirical evidence on the correlation between old age and poverty is mixed (Barrientos, Gorman, and Heslop 2003: 555–70). In Asia, regional studies providing comparable and consistent estimates of old age poverty are scarce.

A poverty reduction objective for social pensions is consistent with social assistance approaches to securing income in old age. This implies the first three main types of old age support identified in the previous section: social assistance provision to all, social assistance with an old age component, and selective social pensions. They all share some form of means test which helps identify older people in poverty or extreme poverty. In all three types, the main objective of provision is to reduce poverty in old age. As will be examined, pursuing a poverty reduction objective through social pensions based on social assistance might actually reduce incentives for active contributors in the working population. Categorical social pensions can also address poverty, insofar as they assist all older people including those in poverty, but other objectives are likely to dominate. From a poverty reduction objective, transfers to older people not in poverty are ineffective in meeting this objective (Thanh Long and Pfau 2009: 333–60).

Another objective of noncontributory schemes is to extend the coverage of pension schemes, which is also important in preventing poverty in old age. In Latin America, for example, rates of poverty among older people are significantly lower in countries with more comprehensive pension coverage and where independent living arrangements for older people are the norm (Barrientos 2006: 781–98). In the context of Asia it is informative to compare the coverage of contributory and noncontributory pension schemes among the older population with the coverage of contributory pension schemes among the working population. Figure 2 summarizes this information for several Asian countries.

**Figure 2: Share of the Population Above Retirement Age Receiving a Pension and Active Contributors in the Working Population (%)**



Data source: ILO (2010) World Social Security Survey 2010/11

As Figure 2 demonstrates, only in a handful of countries do pension contributors exceed half of the working age population. In the majority of countries, a fraction (at best) of the working age population makes a contribution to pension schemes. In fact, a reasonable measure of the incidence of informality is [1- the share of active contributors]. This confirms the high incidence of informality in Asian countries. As most Asian economies are becoming more integrated within the international economy, it is likely that labor markets will remain highly flexible. The reform of contributory pension schemes might generate marginal increases in the share of active contributors in the labor force, but the experience from other regions suggests this is unlikely.<sup>11</sup> Social pensions provide an alternative option for policymakers interested in expanding the share of older people receiving pensions (MacKellar 2009; Palacios and Sluchynsky 2006).

Broadly, three subregional clusters can be identified. The first group includes countries from the former Soviet Union. These countries have high levels of pension coverage among older people. However, the share of active contributors to pension schemes among the working age population is significantly lower. Only Kazakhstan shows active contributor rates above 50%. This suggests that, in the absence of appropriate policies, the rates of pension receipt

<sup>11</sup> Radical pension reform in Latin America, wholly or partially transforming pay-as-you-go defined benefit schemes into funded defined contribution pension schemes in 12 countries of the region, does not appear to have led to a rise in the share of the labor force making regular contributions to pension funds. If anything, the share of contributors has fallen in several countries (Rofman, Lucchetti, and Ourens 2008).



among the older population will decline in the future, increasing vulnerability in old age (Falkingham and Vlachantoni 2010).<sup>12</sup>

Countries in the next group—South Asia—have, with the exception of Nepal, low rates of pension receipt among older people and low rates of active contributors in the working population. The sources of old age vulnerability in these countries come both from labor market informality and a low baseline in pension provision. Nepal is the outlier, most probably due to its categorical social pension.

The third group—East and Southeast Asian countries—contains (i) a group of low- and middle-income countries with relatively low rates of pension receipt among older people and also relatively low pension coverage of the working age population, and (ii) another group of middle- and high-income countries at the bottom of Figure 2 with relatively higher rates of active contributors in the working age population but reduced pension receipt rates among the older population.

For most countries in Asia, the rate of active contributors to pension schemes in the working age population lags behind the share of the older population in receipt of pensions. Only among the bottom five countries in Figure 2 do the rates of pension coverage of the working population exceed the rates of coverage of the older population. Poverty reduction and the expansion of coverage appear to be highly relevant objectives for noncontributory schemes, but these play out differently in different groups of countries.

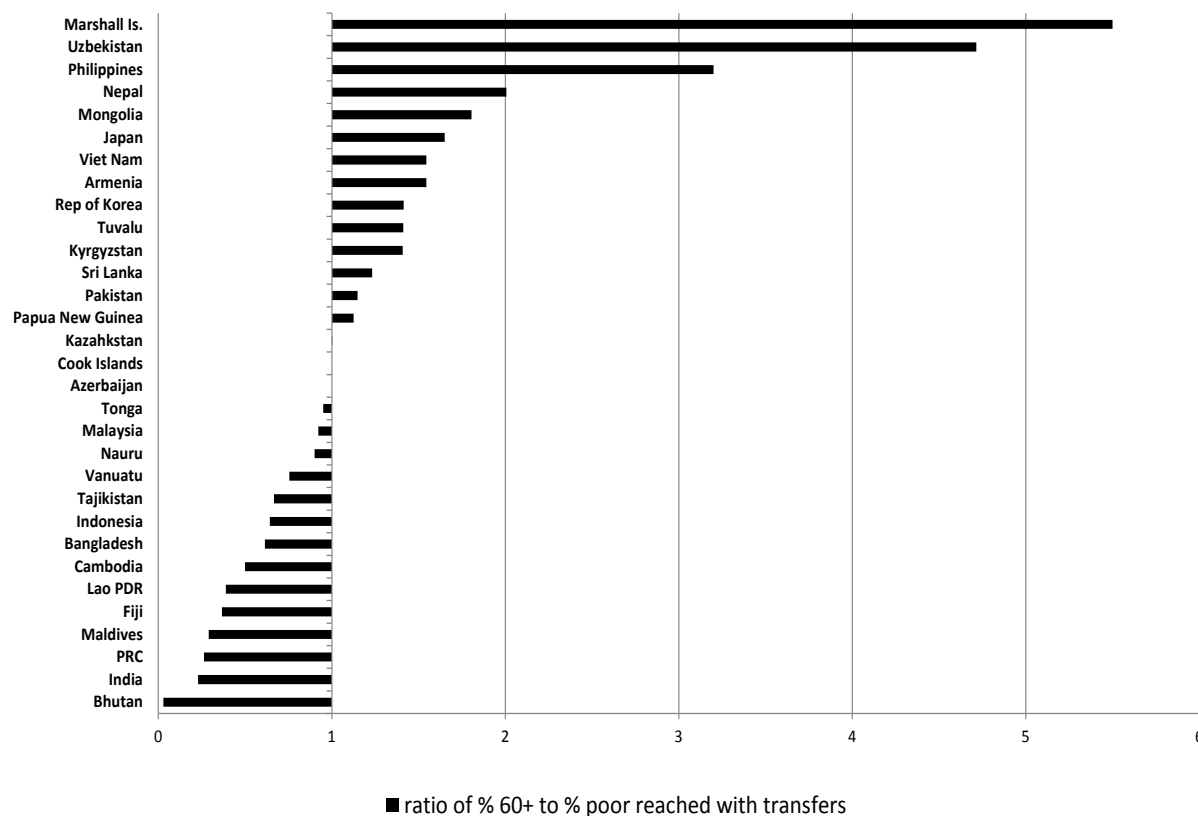
Social pensions based on social assistance could, depending on their eligibility conditions and benefits generosity, have implications for the incentives to contribute to pension schemes, especially among low-income workers. Strong selectivity and low levels of benefits are less likely to generate strong contribution disincentives. Providing benefit levels are low, categorical social pensions could be made consistent with the objective of raising pension receipt coverage. This appears to be the justification in the National Pension Scheme in the Republic of Korea for aiming to cover 60%–70% of older people with the newly introduced noncontributory pension. The integration of categorical social pensions within well-developed contributory pension systems is a significant challenge, as the case of Japan demonstrates.

It is interesting to consider the extent to which policies and institutions of countries weigh up concerns for the population in poverty on the one hand and concerns for the older population on the other. Figure 3 compares the reach of public transfers to older people and to people in poverty. The values in Figure 3 reflect the ratio of the share of older people reached by transfers to the share of people in poverty reached by transfers. Countries with a value greater than 1 for this ratio can be said to be more pro-old in the distribution of public transfers. Countries with values below 1 for this ratio could be interpreted to have a pro-poor slant to their public transfers. This is, of course, only a partial way of assessing the orientation of social policies in the countries concerned.

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<sup>12</sup> It is important to keep in mind that Figure 2 shows the reach of pension schemes but does not throw light on the adequacy of pension benefits.

**Figure 3: Pro-old or Pro-poor?—The Relative Reach of Transfers**



Data source: Wood, J. 2009. *A Social Protection Index for Asia*. Report Singapore: Halcrow Group Limited

There are other policy gaps and objectives which might justify the introduction of noncontributory schemes. Social pensions can be justified in terms of intergenerational redistribution, from younger to older generations. In this context, a categorical pension dominates over alternative design options.<sup>13</sup> Social pensions could be effective in contexts where migration and structural change disrupt family intergenerational support. They are also relevant instruments for countries experiencing rapid demographic change.

Of course, policy design is also constrained by the availability of resources. Low-income countries, with limited resources and high poverty incidence, will in all likelihood prioritize poverty reduction before redistribution in extending the coverage of pension schemes. High-income countries, by contrast, are likely to be more concerned with extending the coverage of pension provision and with ensuring intergenerational redistribution. Cultural values and social priorities are important too, and these further constrain policymakers in the identification of policy needs and gaps and in the type of policy instrument they adopt. Existing institutions tend to restrict the range of policy options too, as demonstrated by the literature on path dependence in welfare reform.<sup>14</sup> The next section explores these trade-offs in more detail.

<sup>13</sup> A comprehensive discussion on this issue is provided by Willmore (2007: 24–51).

<sup>14</sup> In fact, in some countries such as Australia and South Africa noncontributory pensions have always been the main policy instrument used to address old age poverty (Ardington and Lund 1995: 557–77; Knox 1995: 107–10).

### 3. ASSESSING POLICY OPTIONS: POVERTY, INCENTIVES, AND BUDGETS

According to Feldstein, every “society must solve the problem of supporting those individuals who become too old to work but have not made adequate provision for their old age by saving when they were young” (Feldstein 1987: 468–84). Finding solutions to this problem is, to a large extent, dependent on the specific conditions of particular societies, their stage in the demographic transition and economic development, and the nature of pre-existing institutions. This is the justification for focusing first on country-specific conditions and institutions. It is now time to consider briefly some of the policy trade-offs in respect of noncontributory schemes and social pensions, with the help of a basic analytical framework.

#### 3.1 Poverty

Noncontributory schemes consist of tax-financed cash transfers to older people in need. It will be assumed, to begin with, that the main objective is to reduce or eliminate poverty among older people. In developing countries, poverty is normally defined in absolute terms; individuals or households are said to be in poverty if their standards of living are found to be below a minimum threshold or poverty line. It is common practice for countries to set the extreme poverty line at a level equivalent to the cost of a basic basket of food. Households are in extreme poverty if their income is insufficient to secure a basic food supply. In addition to food, access to basic services is also essential to securing minimum living standards. Poverty, as opposed to extreme poverty, is defined as the cost of a basic basket of goods and essential services. Individuals and households found to be above the extreme poverty line, but below the overall poverty line, can be said to be in moderate poverty.

There are several measures of poverty in use in the literature. The measure most commonly used is the poverty headcount rate—the proportion of a population (or group) estimated to be in poverty or extreme poverty, depending on the particular poverty line used. The poverty headcount rate is straightforward to interpret but as a measure of poverty it is problematic as it does not take account of how poor people in poverty are. The poverty gap rate overcomes this disadvantage, as it focuses on the gap existing between the living standards of people in poverty and the poverty line. The poverty gap rate is constructed by adding all the poverty gaps within a population and dividing by the population itself. To enable comparison across time and across countries, the poverty gap is usually reported as a percentage of the poverty line. The poverty gap ratio is sensitive to the depth of poverty, but it does not fully account for the intensity of poverty insofar as it gives the same weight to every \$1 of poverty gap, whether it pertains to a household in extreme poverty or one in moderate poverty. A poverty measure should perhaps assign a higher weight to the poverty gap of the poorest compared to those just below the poverty line. The “poverty gap squared” measure weights the poverty gaps of people in poverty by the poverty gaps themselves, and is therefore more sensitive to the intensity of poverty.

This is important in the context of designing noncontributory schemes. To the extent that policymakers adopt the objective of minimizing the poverty headcount rate, and assuming they have a limited budget, they will be more effective in achieving this objective if they concentrate transfers among those closer to the poverty line. If, on the other hand, their objective is to minimize the poverty gap ratio, it does not matter very much who they target for transfers as long as beneficiaries are in poverty and the transfers do not take them well above the poverty line. Transfers to those above the poverty line fail to minimize the poverty gap rate. Policymakers concerned with the plight of the poorest will focus resources on minimizing the poverty gap squared rate and will allocate their limited budget to the very poorest first. This brief discussion on poverty lines and poverty measures highlights the importance attached to setting poverty reduction objectives for noncontributory schemes.

### 3.2 Incentives

Tax-financed transfers to people in poverty could have adverse effects on economic incentives, which in turn could generate welfare losses in an economy. These need to be considered together with the potential welfare gains from poverty reduction. There are two main sources of disincentives arising from noncontributory schemes: those arising from the additional taxes needed to finance pensions, and those among potential beneficiaries arising from the receipt of the pension benefits. These disincentives will not be considered fully in this paper,<sup>15</sup> but the general implication is that minimizing the costs of the schemes and therefore the need for tax financing will also minimize the adverse effects on the economy.

Noncontributory schemes can also generate adverse incentives to work and save among beneficiaries. Depending on their design, this could be a secondary concern insofar as older people are less likely to be in work, and also in view of the fact that few noncontributory schemes require beneficiaries to withdraw from the labor force. Work disincentives among pensioners will come, if at all, from the income effect of transfers. These are directly linked to pension generosity and the reliability of accessing entitlements. On the other hand, noncontributory schemes could also affect incentives among co-residents insofar as they could lead to moral hazard among co-residents of beneficiaries. The size of this effect will depend on living and financial arrangements within older people's households.<sup>16</sup> There are also potential disincentive effects on saving behavior, and these are likely to be more important in the presence of contributory pensions. Some potential beneficiaries who could otherwise be contributing to social insurance pension schemes may be less inclined to do so if they are able to rely on receiving noncontributory pension transfers in the future.<sup>17</sup>

### 3.3 Budgets

It is important to ensure that the allocation of limited public budgets to support noncontributory schemes is efficient and fair; there is the issue of whether public expenditure on noncontributory schemes could have been put to better use elsewhere. There is also the issue of horizontal equity, i.e., whether noncontributory schemes displace, say, programs focused on child poverty or disability (Barrientos, Gorman, and Heslop 2003: 555–70; Kakwani and Subbarao 2007: 987–1,008; Palacios and Sluchynsky 2006). The budgets allocated to noncontributory schemes matter, both in terms of their aggregate size, because of potential tax disincentives, and also in terms of the foregone opportunities to finance alternative programs with more positive effects on social welfare, greater poverty effectiveness, or fairness, or both. Figure 4 provides an insight into the trade-offs associated with noncontributory schemes.

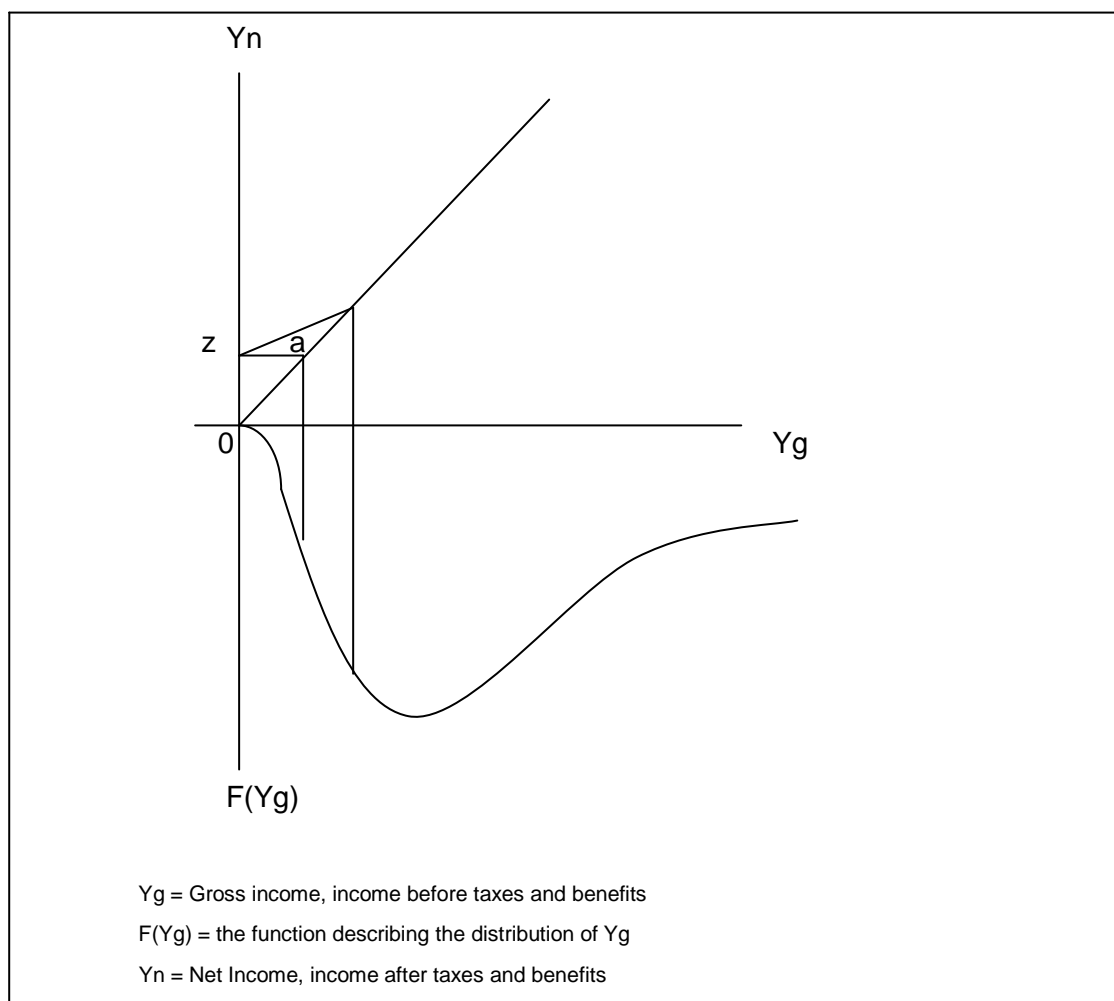
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<sup>15</sup> Examining the impact of noncontributory schemes' tax financing on incentives would need a detailed analysis of tax systems in the region, which is outside the scope of this paper.

<sup>16</sup> The international evidence on labor supply effects from social pensions is mixed. In Brazil, an expansion of noncontributory pensions appears to have reduced employment among older people and also changed living arrangements (Carvalho 2000; 2008: 129–46). In South Africa, some studies find positive labor supply effects (Ardington, Case, and Hosegood 2009: 22–48; Posel, Fairburn, and Lund 2004, 836–53), while others find negative labor supply effects from noncontributory pension receipt (Bertrand, Mullainathan, and Miller 2003: 7–50). Design features and benefit generosity are important here.

<sup>17</sup> Some studies raise the issue of whether noncontributory schemes "crowd out" private transfers, such as remittances (Jensen 2004: 89–112). Conceptually, this is a different issue, to do with the likely effectiveness of public transfers. In a situation where noncontributory schemes simply replace, dollar for dollar, private transfers, it could be argued that the scheme does not meet its objective, but the overall welfare effects of the transfer would need to take account of the improved welfare of donors.

**Figure 4: Poverty Reduction and Incentives Trade-Offs**



Source: Holzmann, Robalino, and Takayama (2009)

In Figure 4, net income is gross income plus transfers (and taxes). The 45° line shows the situation when transfers are zero. The gross income distribution curve in the lower panel shows the number of individuals found at different levels of income and has the typical lognormal distribution. Assume the government decides to provide a transfer to all individuals below the poverty line at  $z$ , equivalent to the poverty gap, the vertical difference is between  $za$  and the 45° line. The poverty gap is  $za0$ , which is also the budget needed to eradicate poverty.

A transfer program of this type will generate welfare gains, especially if financed from taxation of the better-off, and assuming diminishing marginal utility from income. It will also generate work disincentives among individuals in poverty. Setting a social pension at  $z$  implies that individuals with net income below  $z$  would face a 100% marginal tax on any income below the poverty line  $z$ , with clear implications for incentives to work and save up to this threshold. It is possible to reduce the 100% marginal tax by introducing a taper  $zb$  in the figure. The taper provides incentive to work for individuals in poverty, but at some cost. Firstly, the resources equivalent to the area  $zab$  are ineffective in reducing poverty, as they are captured by individuals no longer in poverty. Given the lognormal shape of the income distribution function, the number of people now incorporated as program beneficiaries rises significantly. There is a prima facie case that alternative use of these resources on another poverty reduction program will maximize the poverty reduction effectiveness of public

expenditure. Secondly, the increase in the noncontributory scheme's budget to finance the taper will result in additional disincentive effects for taxpayers.

The trade-offs identified with the help of Figure 4 apply with modifications to alternative designs of noncontributory schemes. Setting a transfer equivalent to the poverty gap for each older person would demand information which is often difficult to collect and is costly to analyze, especially as income is subject to reporting and measurement errors. In the case of older people living with their extended families, the unit of assessment is the household, as opposed to the individual. There is considerable diversity in the practical approaches to the identification of households by delivery agencies across the world (see a discussion on this issue in section 4). A government with weaker administrative capacity would opt for a fixed transfer instead. A transfer equivalent to the poverty line could be shown in Figure 4 by a line starting from  $z$  and parallel to the  $45^\circ$  line. The same trade-offs apply in this case. A government in a low-income country with very limited resources would probably opt for a fixed transfer equivalent to a fraction of the poverty line (see table for examples). This can be shown in Figure 4 by a line starting at some point between  $0$  and  $z$ , and parallel to the  $45^\circ$  line. Some of the disincentive effects are minimized compared to the categorical pension in the previous example, especially as a smaller proportion of the social pension budget spills over to the non-poor. But this is at the cost of smaller welfare gains, as many older people will continue to have standards of living below the poverty line, even after receipt of a transfer.

In summary, the challenges involved in designing noncontributory schemes and social pensions are to do with finding the appropriate combination of welfare gains from poverty reduction, whilst minimizing the adverse effects on the incentives of taxpayers and beneficiaries. Section 4 examines these trade-offs for countries with incipient contributory pension programs, while the case of countries with well-developed contributory pension schemes is covered in section 5.

## 4. SOCIAL PENSIONS AND SOCIAL ASSISTANCE

Grosh and Leite (2009: 161–86) ask the question, are special programs for the elderly poor needed? This is the main focus of this section. The correct answer to this question depends in part on the type of social assistance programs available, and in part on politics.

In theory, comprehensive social assistance programs capable of providing transfers equivalent to the poverty gap can ensure that older people and their households escape poverty. In this context, special programs to address old age poverty would be unnecessary. Comprehensive social assistance programs could have advantages over special programs for poor older people. Increasingly in the developing world, social assistance programs combine a range of interventions beyond income transfers, and focus on households as opposed to individuals. The focus on households is important because it is the locus of agency. Decisions about who goes to work, who goes to school, and how household resources and assets are deployed are made at the household level. Supporting households as opposed to individuals could generate stronger and more permanent pathways out of poverty. Many social assistance programs in developing countries have adopted a multidimensional view of poverty, which places a value on the coordination of different public agencies and coordinates their support for households in poverty.

Special programs for older people, on the other hand, often ignore the fact that these people live in households, and they are instead treated as separate economic and social units. Where transfers are shared within households, benefits sufficient to take individual pensioners out of poverty might prove insufficient when distributed across household members. In areas of acute and persistent poverty, noncontributory schemes could turn out to be the only lifeline for co-resident families, increasing the financial responsibility of older persons. The entitlement rules for noncontributory schemes and social pensions might

themselves encourage older people to seek separate living arrangements and break up support networks. There is also the point that income transfers to older people might not be effective by themselves to secure access to basic services or support.

In practice, social assistance programs often discriminate against older people. This is particularly the case in poverty reduction programs with a development orientation. The National Employment Guarantee Scheme in India, for example, provides 100 days of guaranteed employment to unemployed heads of household in rural areas on the condition that families supply labor for infrastructure projects. The type of labor required can rule out older people from benefiting. Employment guarantees, public works, micro insurance and microfinance, and human development programs all tend to have implicit or explicit age restrictions, which act to exclude older people. In these circumstances, special programs for older people are appropriate and necessary within social assistance schemes or as separate social pensions (Barrientos 2009).

There are important insights on this issue emerging from the theoretical literature on transfers and incentives. Akerlof (1978: 8–19) demonstrates that, in a situation in which poverty is strongly associated with a particular category of people in a population, categorical transfers prove more efficient in terms of minimizing the distortions to the tax structure and providing higher levels of benefit. Extending this argument to noncontributory schemes, the suggestion is that "tagging" older people within the general population group might prove to be a better option than generalist social assistance. Take a hypothetical situation in which concerns with the incentive effects of assistance persuade policymakers to reduce to a minimum the level of transfers to households in poverty. However, within that group there is a large subgroup of older people for whom the potential disincentives to work are small, relative to the situation of poor households with adults of working age, and the potential disincentives to save for old age are considered less relevant. There might be a case for separating out older people from households with adults of working age within the social assistance scheme. This might make it possible to raise benefit levels to older people in poverty without additional disincentive effects.<sup>18</sup>

So far we have considered the case of special components for older people within social assistance, but it is interesting to consider whether the same argumentation could support a separate social pension program, whether means tested or categorical. In principle, the differences existing between programs within social assistance schemes and self-standing social pensions, but with similar features, are likely to be small from the perspective of balancing poverty reduction and incentive effects. On paper, a social pension and a special social assistance component with the same features are likely to produce similar outcomes. In practice, differences may emerge from the actual implementation of the program, e.g., from the differential capacity of public agencies, and also from differences in the public and political support for the program.<sup>19</sup> Self-standing social pensions have greater visibility and require stronger political support. They are also likely to raise questions of horizontal equity across groups of households in poverty if self-standing social pensions are not accompanied by child subsidies or family allowances, for example.<sup>20</sup>

The more interesting case is whether tagging can provide a justification for categorical social pensions, also known as universal social pensions. In fact, this is the empirical backdrop in Akerlof's classic paper (Akerlof 1978). There would be a *prima facie* case for tagging older

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<sup>18</sup> Examining the countries in the table is instructive in the context of this hypothesis. Sri Lanka has a generalist social assistance scheme, while Kyrgyzstan has a separate old age component within social assistance transfers, with benefits to older people (and children with disabilities) set at a significantly higher rate than for households with adults of working age (and children) in poverty.

<sup>19</sup> On this point see Mujahid, Pannirselvam, and Doge (2008). For countries in the former Soviet Union see Falkingham and Vlachantoni (2010).

<sup>20</sup> In South Africa, for example, the point is often raised that transfers focused on children and older people leave families affected by unemployment outside social assistance (Van der Berg 2002: 39–68).

people with a categorical pension in conditions where old age is closely correlated with poverty, and also in a context in which older people are not expected to work. As has been discussed, old age and poverty are not always correlated in developing countries, although this might itself be a consequence of the strength of pension provision. And because social pensions in developing countries largely lack inactivity tests for eligibility, the adverse labor supply effects will be down to income effects.

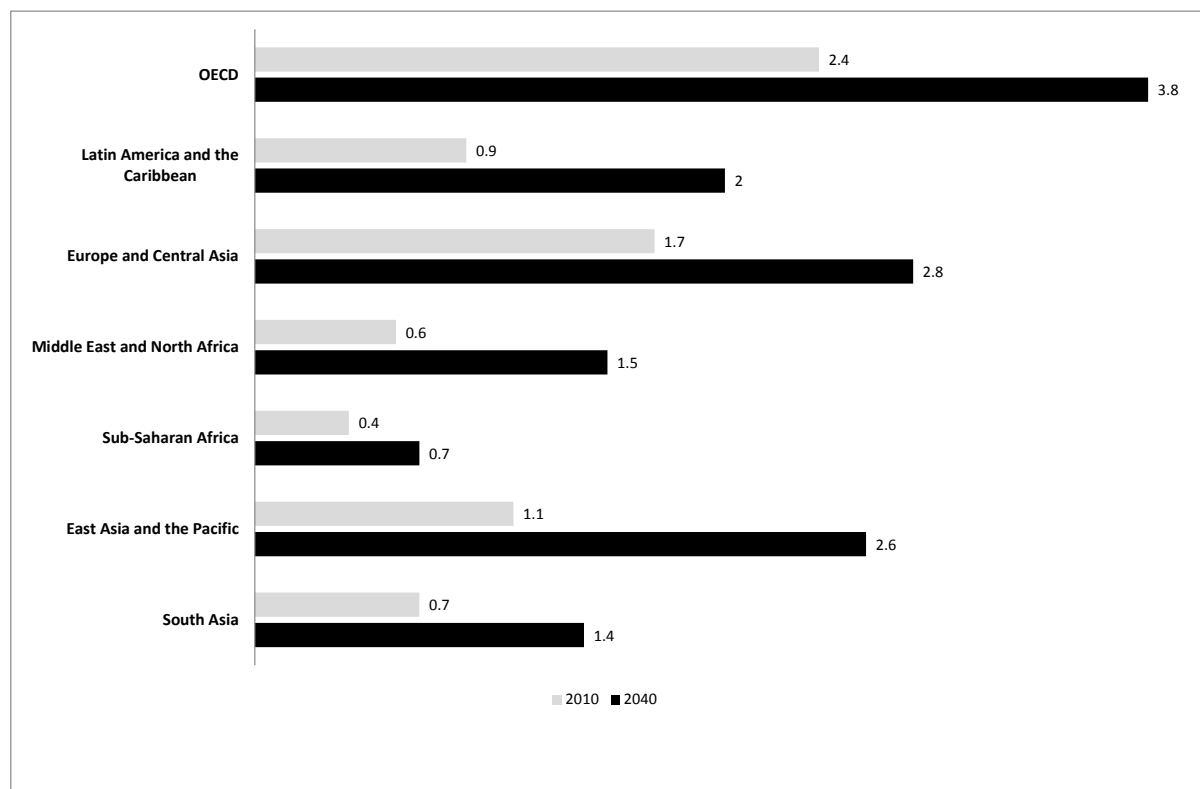
Feldstein (1987: 468–84) considered the welfare effects of categorical versus means tested social pensions. His main conclusion is that means tested social pensions dominate, but categorical programs would generate higher welfare in two situations. Firstly, where a means tested social pension induces a large number of workers who otherwise might be able to save for their retirement to stop saving and instead rely on the social pension. This would be the case if the distribution of income has a spike just above the means test threshold for entitlement, e.g., there are large numbers of workers with savings sufficient to support standards of living in retirement just above the poverty line. The second case has to do with situations in which the means tested social pensions need to be set at a very low level to sustain incentives to work and save. Low pension benefits might be associated with welfare losses arising from the deprivation of social pensioners greater than the welfare losses from adverse incentives to work and save. In these circumstances, categorical pensions deliver higher levels of welfare.

In the context of developing countries with limited resources, consideration needs to be given to the size of the budgets required, especially where the incidence and depth of poverty are significant, and where resources to assist older groups compete with resources to support other age groups. It is also important to look at the changes in the budget over time. Palacios and Sluchynsky (2006) provide estimates of budget levels required to finance a categorical pension of 15% of per capita gross domestic product (GDP) to people aged 65 and over for different regions (Figure 5). Their estimates show that, for countries in Asia, the required budgets roughly double between 2010 and 2040, to 1.4% of GDP in South Asia, 2.6% of GDP in East Asia and the Pacific, and to 2.8% in Europe and Central Asia. The sustainability of categorical social pensions needs to be considered in the medium term.



**Figure 5: Budget Estimates of a Categorical Pension as % of GDP**

Benefit of 15% of per capita GDP for all people aged 65 and over



GDP is Gross Domestic Product. OECD is Organization for Economic Co-operation and Development

Data Source: Palacios and Sluchynsky (2006).

This section examined the trade-offs between poverty reduction and incentives associated with alternative forms of assistance to older people. The main objective was to clarify the nature of the options and their effectiveness. References to the theoretical literature helped to identify these trade-offs within a welfare theoretic framework. The main conclusions from the discussion in this section are that alternative forms of support to older people in need are possible. Generalist social assistance schemes which include older people can be effective in securing basic living standards for this group. In practice, many social assistance programs implicitly or explicitly discriminate against older people. Countries relying on generalist social assistance to address old age poverty should look to reform social assistance to eliminate age restrictions in access to assistance. It might be possible to secure higher levels of support for older people through special components of social assistance schemes or through self-standing social pensions, without additional adverse effects on incentives. This will be a strong consideration in conditions where there is a close correlation between old age and poverty and where work disincentives among the old can be minimized. Means tested social pensions dominate categorical pensions in terms of their welfare effects, but there are situations in which the theoretical literature would recommend categorical pensions. Political and public support and horizontal equity issues are also relevant to the selection of alternative social pension designs.

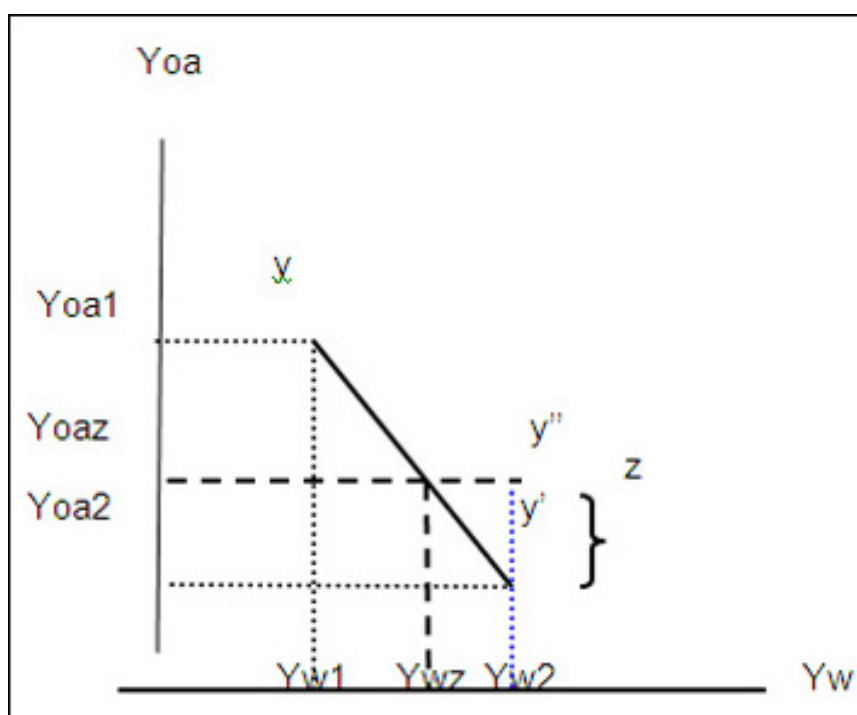
## 5. NONCONTRIBUTORY AND CONTRIBUTORY PENSION SCHEMES

In countries with well-developed contributory pension schemes, appropriate policy options are different. The policy interest in noncontributory schemes and social pensions for

countries such as the Republic of Korea and Malaysia is motivated by the need to expand the coverage of pension provision among older people, in circumstances where changes in the labor market and/or rapid population ageing limit the expansion of contributory pension schemes (Asher 2010: 319–39). Here, the trade-offs between poverty reduction, incentives, and fiscal cost recommend retaining strong incentives for workers to contribute to social insurance schemes.

An entry point into this set of issues is to consider the behavioral responses to the implementation of a social pension from workers who are able to make their own arrangements for old age through contributory pension schemes. Valdés-Prieto (2008) develops a model of contribution density for the "middle classes" which is very helpful for exploring the implications flowing from the introduction of a social pension in contexts where well-developed contributory provision is in place. In the model, workers' pension benefits are determined by the density of their contribution over their working lives, measured as the proportion of their working lives for which they are able to make contributions to a pension scheme.

The model assumes a worker can manipulate his or her contribution density by moving from covered to non-covered employment (say formal to informal employment). In non-covered employment, wages before payroll contributions are lower than in covered employment, due in part to differences in productivity between the two sectors, but also to the fact that payroll taxes are subtracted in covered employment. To simplify the main parameters of the model,  $Y_{oa}$  is taken to indicate income in old age, and  $Y_w$  to indicate income during a person's working life. In Figure 6, the segment  $y-y'$  represents the trade-offs for the worker; the slope of  $y-y'$  reflects the rate of return on pension contributions.

**Figure 6: Noncontributory Pensions and Contribution Density**

$Y_{oa}$  is income in old age

$Y_w$  is income while in work

$y-y'$  represents feasible trade-offs between  $Y_{oa}$  and  $Y_w$

$Y_{w1}$ ,  $Y_{oa1}$  reflect situation of workers with maximum contributions

$Y_{w2}$ ,  $Y_{oa2}$  reflect situation of worker with zero contributions

$z$  represents a non-contributory pension,  $Y_{oaz}$  is associated income in retirement

Source: Adapted from Valdés-Prieto [2008]

In the absence of a social pension, a worker who makes zero contributions ( $Y_{w2}$ ) maximizes current consumption at the expense of consumption in old age,  $Y_{oa2}$ . By contrast, a worker with a high density of contributions ( $Y_{w1}$ ) stands to enjoy  $Y_{oa1}$  in retirement. If a flat rate social pension equivalent to  $z$  is now introduced for workers with zero contributions, those workers with contribution densities between  $Y_{wz}$  and  $Y_{w2}$  can now secure income  $Y_{oaz}$  in retirement and therefore have strong incentives to make zero contributions. In this particular case, the introduction of a social pension would weaken contribution incentives.<sup>21</sup>

Evaluating the welfare impact of the introduction of a social pension of this type would need to take account of the welfare losses associated with the reduction in contributions. As was pointed out by Feldstein (1987: 468–94), the size of these effects depends to an important extent on the proportion of workers directly affected.

What about alternative social pension design?<sup>22</sup> A categorical social pension would have the advantage in this context that it would leave contributory incentives for these workers unaffected: imagine a line starting at  $y''$  in Figure 6 and parallel to  $y-y'$ . But the necessary budget allocations would be large, with implications for the size of the likely tax distortion.

<sup>21</sup> Levy (2008) discusses this in the context of Mexico.

<sup>22</sup> For a discussion of hybrid schemes, see Feldstein (1987: 468–84) and Valdés-Prieto (2009).

Other design features can be important. Setting the age of eligibility for social pensions higher than for contributory pensions might work to strengthen contribution incentives. Setting the minimum benefit level for contributory pensions higher than the level for noncontributory pensions would also help to strengthen contribution incentives. The upshot of this discussion is that the integration of contributory and noncontributory pensions is difficult to achieve. These design features might be difficult to sustain politically.<sup>23</sup>

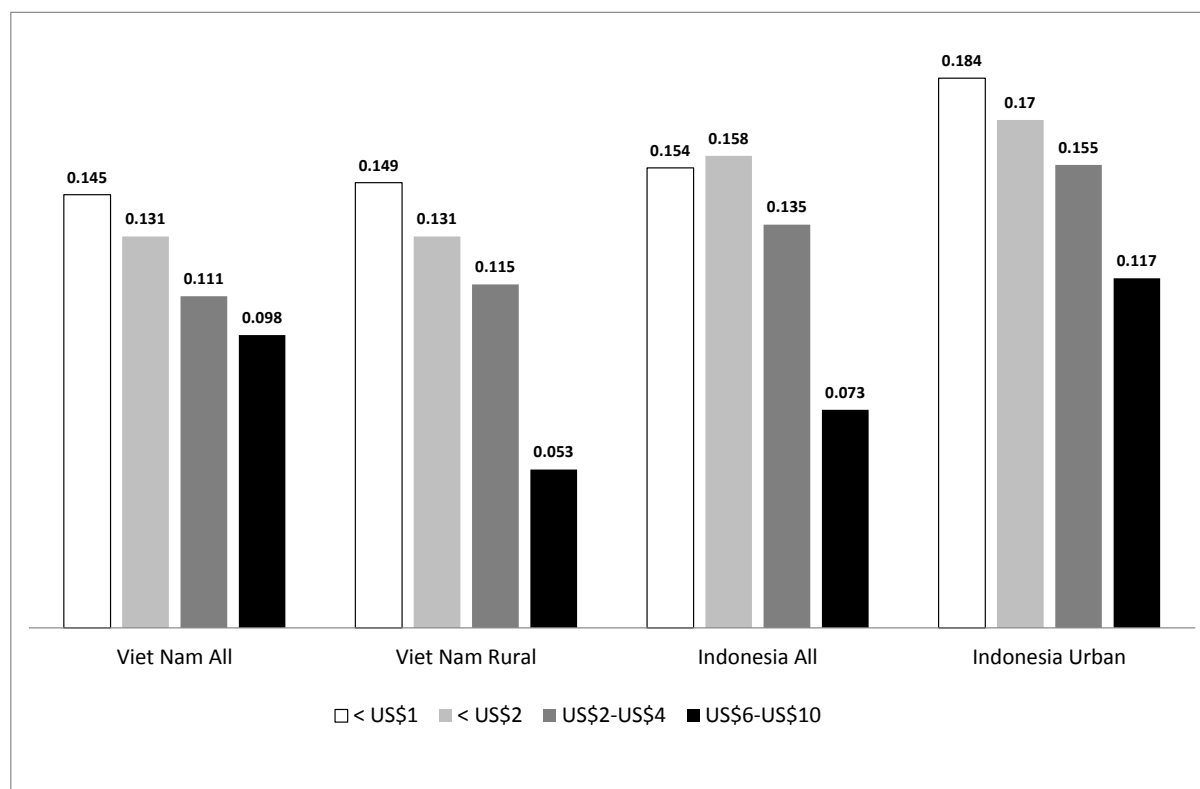
Some countries set a late age of entitlement for categorical social pensions in an effort to improve incentives and/or reduce budget allocations. Nepal is a case in point. The correlation between income and wealth on the one hand, and longevity on the other, suggests there are implications from adopting a late age of entitlement for poverty reduction effectiveness and horizontal equity. To the extent that wealthier people live longer, it follows that they have an actuarially greater probability of collecting their social pension, and will draw relatively larger benefits from the scheme than poorer people. A study of longitudinal surveys for two Asian countries provides some confirmation of this point, although it is very difficult to get a sense of the size of the likely effects (Banerjee and Duflo 2007). Figure 7 illustrates this point for Viet Nam and Indonesia. It shows a declining rate of mortality among older people in better-off households, especially in rural areas.

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<sup>23</sup> Brazil's noncontributory pension scheme, *Benefiçao de Prestaçao Continuada (BPC)*, initially had a minimum age of entitlement set at 67, while the contributory scheme's age of eligibility was 65, but subsequent governments lowered the age of entitlement for the noncontributory scheme to 65 in an effort to reduce old age poverty.

**Figure 7: Income-Mortality Gradient Viet Nam and Indonesia**

Fraction of respondents over 50 in 1993 who died by 1997



Source Data: Banerjee and Duflo (2007).

This section aimed to throw light on the social welfare effects of social pensions in the context of countries with well-developed contributory pensions. Balancing old age poverty reduction, incentives to work and save, and budget costs becomes harder in this context. Concerns over the impact of labor market liberalization and rapid population ageing in the more developed economies of the region has stimulated policy discussion on how best to strengthen social pensions. In Japan and the Republic of Korea, the status, design, and scope of social pensions is under discussion (Kwon 1999; Moon 2009: 119–24; Takayama 2009). The discussion in this section finds that the core issue is how to balance an extension of pension provision to older people whilst maintaining incentives for workers to remain in contributory pension schemes. Few insights into general applicability emerge from the literature on this point. Categorical social pensions generate fewer distortions on contribution incentives than means tested social pensions, but they entail significantly larger budgets.

## 6. CONCLUSIONS

This paper has provided an assessment of social pension programs in Asia. It began by presenting and discussing summary information on noncontributory schemes, including social assistance and social pensions, and guaranteed minimum pensions under contributory schemes in selected countries. Social pensions are located within a continuum of policies addressing old age poverty and vulnerability. There are important policy links existing between social pensions and social assistance on the one hand, and contributory pension programs on the other.

The paper considered the diversity of approaches in Asia by reference to several countries, and identified four main types of noncontributory policy responses to old age poverty and vulnerability: generalist social assistance, social assistance with an old age component,

selective or means tested social pensions, and categorical social pensions. A fifth type, minimum pension guarantees within contributory schemes, was not considered, except for its links with noncontributory social pensions.

The paper then considered the relationship between policy needs, the objectives of noncontributory schemes, and program design. Noncontributory schemes can address a variety of policy needs, including old age poverty reduction, the extension of pension schemes coverage, rapid population ageing, and the impact of migration and globalization on older people. The discussion focused on the relationship between poverty reduction and coverage extension objectives. It identified areas of overlap as well as potential conflict of objectives. They help explain the diversity in policies addressing old age vulnerability in Asia.

Section 3 attempted an assessment of the social welfare impact of alternative policy options. The approach adopted was to focus on three key parameters of social pensions: poverty reduction, incentives, and budgets. The analysis focused on two key policy nodes: the comparative advantage of social assistance and social pensions, and the links between noncontributory and contributory pension schemes. The first policy node is relevant to low- and middle-income countries with incipient contributory pension schemes. The second policy node reflects the situation of middle- and high-income countries with well-developed contributory pension schemes.

Social assistance transfers and self-standing social pensions provide competing options. In theory, generalist social assistance, if well designed and implemented, could provide an effective means of addressing aggregate poverty, including old age poverty. On paper, generalist social assistance can ensure horizontal efficiency and fairness, as any public support to overcome poverty is provided to all. In practice, however, generalist social assistance institutions tend to discriminate against older people through implicit or explicit age restrictions. Support to older groups provided through special social assistance components focused on age can have advantages. Separating out older people can enable policymakers to provide a higher level of support with a reduced impact on incentives. Depending on design, selective social pensions tend to generate similar outcomes. Categorical social pensions can be effective in addressing old age poverty but require significantly higher budget allocations. The broad conclusion from the theoretical literature is that selective social pensions can be more effective than categorical pensions, but there are circumstances in which categorical pensions are preferable.

Combining noncontributory and contributory pension programs requires considerable care in maintaining contribution incentives. In the presence of well-developed contributory pension schemes, generous social pensions can reduce contribution incentives, especially among low-income workers. Reducing the generosity of pension benefits and/or raising the age of entitlement in noncontributory pensions might help strengthen contribution incentives, but in the process gains in social welfare are significantly reduced. The age–wealth gradient makes it problematic to rely on a late age of entitlement for social pensions, whether selective or categorical. In categorical social pensions, the wealthy have an actuarially higher probability of drawing benefits than low-income groups.

Noncontributory schemes can also help address other policy challenges in Asia, including rapid population ageing and rapid economic transformation. The main conclusion from the discussion in this paper is that several policy options are available and they need to be considered carefully in the context of country-specific conditions and existing institutions. Research and data on the well-being of older groups, together with an assessment of the political and political economy factors facilitating or constraining policy, will be essential to the success of country and regional strategies.

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