

# **BRIEFING PAPER**

## **GLOBAL UPDATE ON TRENDS IN INCOME SECURITY IN OLD AGE**

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Briefing Paper prepared for the  
AARP and United Nations Programme on Ageing/DESA  
Briefing Series on Major Developments and Trends in Global Aging  
United Nations, New York  
February 7-9, 2007



## **Global Update on Trends in Income Security in Old Age<sup>1</sup>**

The other determinants – economic development and governance factors – being equal, ageing is the most important factor of influence on social transfers to elderly populations (both formal and informal) which are, in turn, the biggest expenditure items in developed national social protection systems. That impact is especially strong in mature systems in societies with a high proportion of elderly people covered by social security. However, while developed regions are substantially “older” than less developed ones, the pace of ageing is actually much faster in the developing world. The less developed countries in relative terms will face an even more serious ageing problem between 2000 and 2050 and have to build strong transfer systems well prepared to face this challenge.

Nonetheless, although pension schemes may face increased demographic dependency, the challenge appears to be much smaller for overall social security systems: the combined number of children, those of working age who are inactive and elderly per 100 economically active people is declining globally. This is largely due to a rapidly declining number of children and growing labour force in the developing world. The picture may again be to some extent misleading as – for the time being – a large proportion of the economically active belong themselves to the working poor thus with no or limited capacity to finance transfers to those inactive.

One of the most dramatic aspects of the demographic transition is rapidly dropping fertility rates. The global average fertility rates dropped within the three decades between 1970-75 and 2000-05 from 4.49 to 2.65, i.e. by about 40 per cent. This is by no means a phenomenon that only applies to developed countries.

### **Countries with developed social security systems and relatively high coverage**

The challenge posed by the global demographic transition to social transfer systems is manageable – as shown by the results of recent projections for 25 EU Member States of the costs of all age-related social transfers until 2050.<sup>2</sup> Total age-related public spending on pensions, health care, long-term care, education and unemployment benefits are expected to increase on average in 25 European Union member countries from 23.4% of GDP in 2004 up to 26.8% of GDP in 2050. There are obvious problem cases among these 25 countries but an average cost increase of less than four percentage points of GDP over a period of 45 years appears to be a rather benign scenario. When one looks at just public expenditure on pensions, the expected increase is from 10.6% of GDP in 2004 up to 12.8% of GDP in 2050.

Of course, such a relatively modest expected expenditure increase of less than 21% while expected increase in demographic dependency ratios - with all other things staying constant (no economic growth and policy changes) - would add to pension expenditure nearly 80% over the same period, is a result of expected effects of already implemented reforms and policy changes pushing up employment rates and actual

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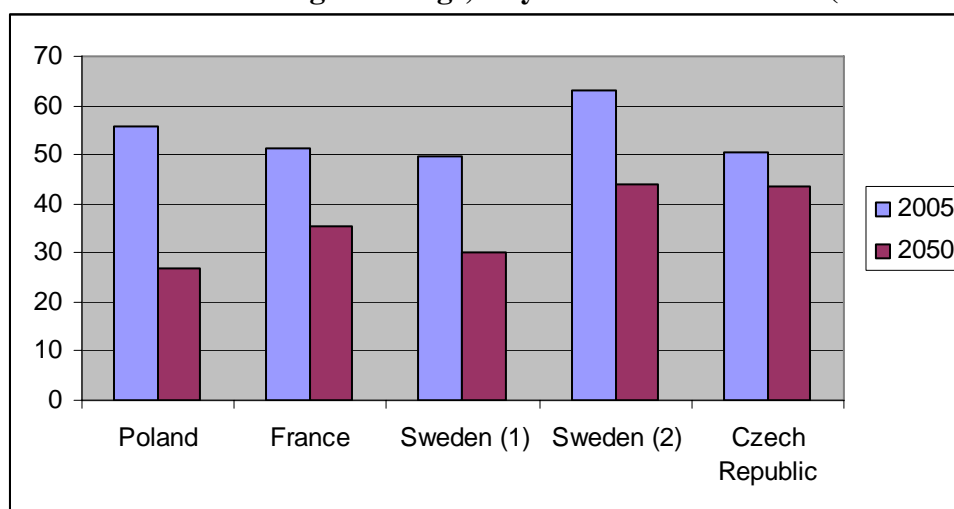
<sup>1</sup> This note is based: ILO Social Security Department, 2006: Social security for all: Investing in global social and economic development: A consultation, Issues in Social Protection Discussion Paper 16 (Geneva: ILO), <http://www3.ilo.org/public/english/protection/secsoc/downloads/1519sp1.pdf> and few other recent publications by the ILO Social Security Department.

<sup>2</sup> European Commission: *The impact of ageing on public expenditure: Projections for the EU 25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)*, report prepared by the Economic Policy Committee and the Directorate General for Economic and Social Affairs (DG ECOFIN), Report No. 1/2006 (Brussels, 2006).

retirement ages and pushing down benefit levels. Unfortunately, this is expected to happen to a large extent due reforms and policies reducing replacement rates of newly awarded benefits and allowing pensions already in payment to lag behind growing wages and productivity. As the report quoted above shows, the ratio between average benefit and average GDP per employed person will decrease over next 45 years by more than one fifth for the EU as a whole. There are countries however, where the results of the recently introduced radical reforms may reduce this ratio by half or more.

Figure 1 shows expected theoretical replacement rates for selected EU Member States as reported in their national pension strategy reports. It demonstrates that people with broken careers (mostly women due to uncompensated reproductive work and other family responsibilities and all those with longer spells of unemployment due, inter alia, to increasing labour market volatility) will in future most likely face replacement rates that may no longer meet the requirements of the relevant ILO conventions (like Convention No. 102 on minimum standards in social security).

**Figure 1. Theoretical gross replacement rates in selected European Union Member States: Average earnings, 30 years of contributions (broken careers)**



Sweden (1): national pension system only; Sweden (2): including occupational pensions.

Source: Own comparative analysis of data included in national pension strategy reports as available on [http://europa.eu.int/comm/employment\\_social/social\\_protection/pensions\\_en.htm](http://europa.eu.int/comm/employment_social/social_protection/pensions_en.htm)

It is obvious that not only countries that embarked on so-called paradigmatic reforms (like Sweden, Poland and a number of other countries) will see replacement rates going down. Substantial reductions in expected replacement rates in France, for example, show that even so-called parametric reforms may reduce future benefits quite considerably, unless people are willing and able to contribute significantly longer and retire much later. This however requires much more than just a pension reform.

### **Low income countries facing the coverage gap**

Due to their lower earnings capacities, older persons are among the most vulnerable groups of the population in low-income countries. Only a small proportion of older people have access to old age pensions from social insurance schemes. For example, in Burkina Faso, 1.6 per cent of the population over the age of 65 receives an old age pension, and less than 2.8 per cent of today's economically active

population in working age is affiliated to old-age pension scheme. The large majority of older persons have to rely on traditional support capacities of families and communities which are eroding due to the impact of HIV/AIDS, migration as well as pervasive chronic poverty and destitution.

There exists also significant gender imbalance in coverage ratios: as many social security schemes are employment related and employment rates are lower for women than for men, even in developed countries actual coverage rates are much lower for women than for men.

To overcome these coverage gaps and resulting income insecurity of the elderly, a number of middle and low-income countries have introduced non-contributory old age pensions for their elderly population. Countries with social pension schemes include Brazil, Botswana, India, Mauritius, Lesotho, Namibia, Nepal and South Africa. Evidence from those countries shows, that such social pensions have a remarkable impact on the living standards of elderly persons and their families, namely on children.<sup>3</sup> Recent ILO micro-simulations show, for example, for the cases of Tanzania and Senegal, that the combination of basic universal old age pensions and child benefits to school children and orphans under the age of 14 would reduce overall poverty by more than one third at an affordable cost.<sup>4</sup>

Results of the simulations recently published by the ILO<sup>5</sup> show that universal basic pensions are feasible and accessible for low-income countries, such as those in Africa or Asia. The ILO simulations covered two variants of universal basic pensions. In the first variant, it was assumed that a universal old age and disability pension of US\$0.50 PPP would be paid to all men and women aged 65 or older; and to persons with serious disabilities in working age (assumed as 1 per cent of the working-age population). It was assumed that the benefit value would be indexed to inflation over the projection period.

Based on these assumptions, the costs of providing a universal basic old age and disability pension is estimated at between 0.3 and 1.0 percent of GDP in the countries considered (see Figure 2). Projected costs for 2010 remain well below 0.5 per cent of GDP in seven of the twelve countries, while Burkina Faso, Ethiopia, Kenya, Nepal and Tanzania find themselves between 0.5 and 1.0 per cent of GDP. In a second variant, the level of benefits was assumed to be fixed at 30 per cent of GDP per capita. All other parameters were kept the same as in the first variant. Based on these assumptions, the estimated costs for a universal old age and disability

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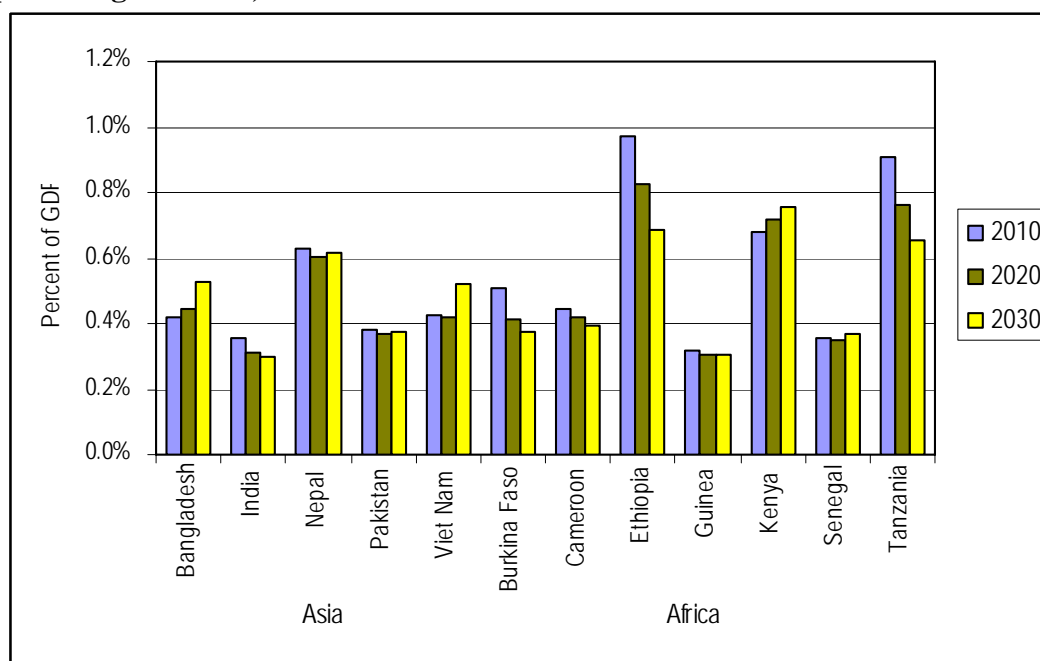
<sup>3</sup> Barrientos, A. and Lloyd-Sherlock, P., 2003: Non-contributory Pensions and Social Protection, Issues in Social Protection Discussion Paper 12 (Geneva: International Labour Office),  
<http://www3.ilo.org/public/english/protection/secsoc/downloads/543sp1.pdf>.

<sup>4</sup> See: F. Gassmann, C. Behrendt: Cash benefits in low-income countries: Simulating the effects on poverty reduction for Tanzania and Senegal, Issues in social protection series, Discussion paper 15, ILO Social Security Department (Geneva, 2006).  
<http://www3.ilo.org/public/english/protection/secsoc/downloads/1515sp1.pdf>

<sup>5</sup> Pal, K.; Behrendt, C.; Léger, F.; Cichon, M., and Hagemeyer, K., 2005: Can Low Income Countries Afford Basic Social Protection? First Results of a Modelling Exercise, Issues in Social Protection Discussion Paper 13 (Geneva: International Labour Office),  
<http://www.ilo.org/public/english/protection/secsoc/downloads/policy/1023sp1.pdf>  
Mizunoya, S.; Behrendt, C.; Pal, K., and Léger, F., 2006: Can Low Income Countries Afford Basic Social Protection? First Results of a Modelling Exercise for Five Asian Countries, Issues in Social Protection Discussion Paper 17 (Geneva: International Labour Office),  
<http://www3.ilo.org/public/english/protection/secsoc/downloads/1527sp1.pdf>

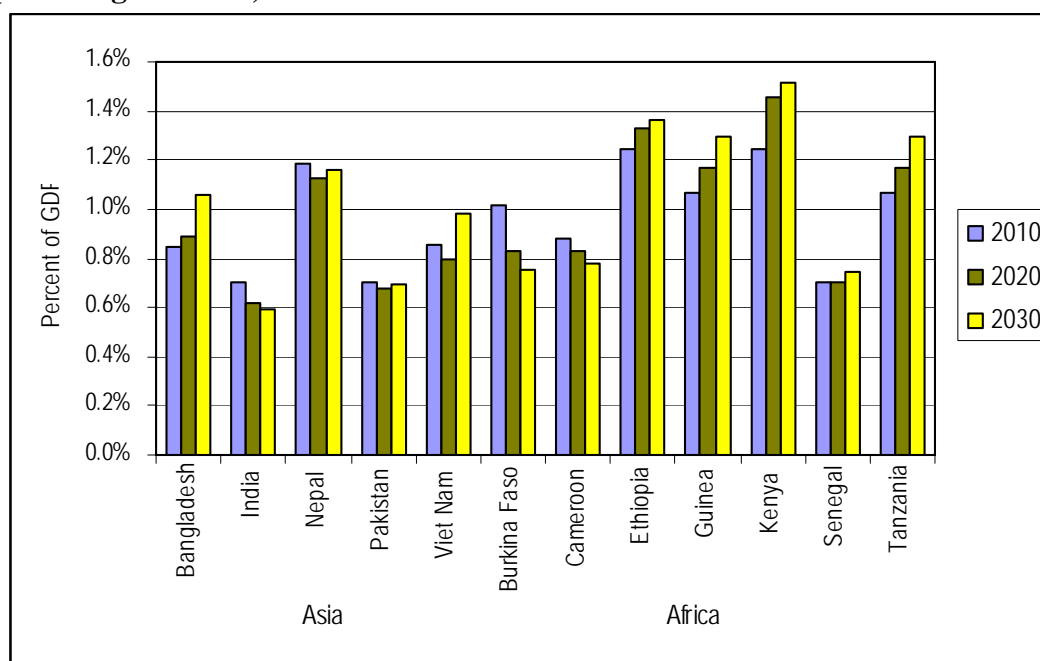
pension is more homogenous across countries and would reach between 0.7 and 1.2 per cent of GDP in 2010 (see Figure 3).

**Figure 2** Costs for basic universal old age and disability pensions as a percentage of GDP, Variant I



Source: Based on Mizunoya, et al., op.cit. and Pal, et al, op.cit. These figures include assumed administration costs of 15 per cent of benefit expenditure.

**Figure 3** Costs for basic universal old age and disability pensions as a percentage of GDP, Variant II



Source: Based on Pal, et al. op.cit; Mizunoya, et al. op.cit. These figures include assumed administration costs of 15 per cent of benefit expenditure.