

## Chapter 1

# Policy issues: Coverage and adequacy

*The general issue of coverage and more specifically contribution density is covered in Chapter 1. Coverage, defined both as the proportion of workers participating in pension schemes and the proportion of the elderly receiving some kind of pension income, continues to be the most important pension challenge in the region. In the two decades that followed the pension reforms in Latin America, the share of workers contributing to a pension system of any kind barely changed in most countries, leading to a growing emphasis on policies that would address the stubborn coverage gap. While two countries may have similar, even identical system designs, a significant difference in the patterns of contribution or life expectancy at retirement age would in practice, yield different actual outcomes. Recognising the particular importance of this limitation for Latin America where there is evidence of low contribution density, especially at the lower end of the income scales, Chapter 1 of the report extends the usual micro-level analysis and reports on the sensitivity of the results.*

## Coverage and contribution density

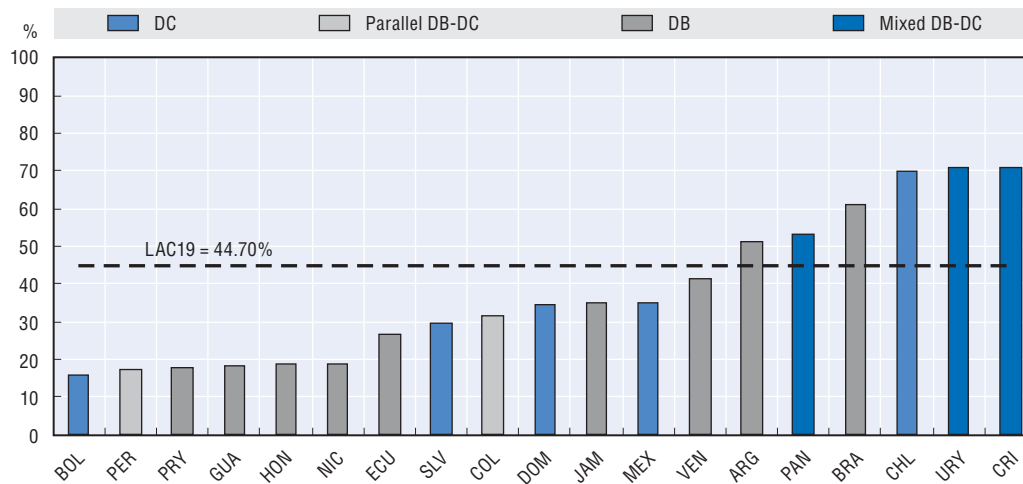
Active coverage,<sup>1</sup> defined as the participation of workers in mandated pension schemes, one of the conventional measures of formality,<sup>2</sup> is low in much of Latin America and the Caribbean (LAC). Some countries in the region have made significant progress in terms of expanding the proportion of those aged 65 or older who are actually receiving pension benefits, mostly due to the implementation of non-contributory pensions and special regimes for the self-employed. Even in countries where a large percentage of the labour force contributes to pension, pension contributions are often too irregular to finance adequate old-age pensions for the majority of the population. Following the model of traditional Bismarckian social insurance systems that is common in many OECD countries, participation in pension saving schemes in LAC is largely determined by participation in formal employment offering social protection coverage and accumulated pension contributions. Policy makers in LAC face important challenges on both fronts, given the low female participation rates and widespread informality in the region, which results in a lack of coverage for some and low contribution densities for others.

According to 2010 household surveys in a range of countries,<sup>3</sup> affiliation with and contributions to pension systems are low on average in LAC and very low in many countries. On average, only 45 in each 100 workers (aged between 15 and 64 years old) are contributing to or affiliated with a pension scheme in the 19 countries analysed (see Figure 1.1).<sup>4</sup> In other words, approximately 130 million workers were not contributing in 2010 to an old-age pension scheme. This situation is especially pronounced in some Andean and Central American countries (Bolivia, Guatemala, Honduras, Nicaragua, Paraguay and Peru) where less than 20% of the total workforce are contributing. Another group of countries, some of them among the most dynamic of the region (such as Colombia, the Dominican Republic and Mexico), only 30 to 40% of all workers contribute. Finally, in most higher-income countries by regional standards, such as Argentina, Brazil, Chile, Costa Rica, Panama and Uruguay, between 50 and 70% contribute. This is still low by international standards (Jütting and de Laiglesia, 2009).

Structural pension reforms during the 1990s in LAC, following the early experience of Chile in 1981, did not change this picture (see Box 1.1 for a description of the evolution over the last two decades). As Figure 1.1 shows, a range of different pension schemes have been implemented in the region from the traditional defined-benefit pay-as-you-go public systems to defined contributions based on individual capital accounts managed by the private sector along with parallel and mixed structures. Overall, no particular type of pension scheme predominates in terms of having higher pension contribution frequencies and higher numbers of formal sector workers. (For an analysis of the macroeconomic effects of structural pension reforms, see Gill et al., 2005 and for a focus on labor market dynamics, see Bosch et al., 2013.)


The low levels of contribution to pension schemes correlate to a series of socioeconomic characteristics. Educational attainment has a powerful impact on the likelihood of contributing to pension systems; more educated workers are more likely to contribute than less educated workers. Data from the same household surveys show that, on average, only

Figure 1.1. **Contributors or affiliates as a percentage of total workers (aged 15-64 years), around 2010**



DB = Defined benefit; DC = Defined contribution.

Source: Bosch, M., A. Melguizo and C. Pagés (2013), "Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean", Inter-American Development Bank, Washington, DC.

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### Box 1.1. **Main trends in pension savings in Latin America and the Caribbean since the 1990s**

Using available household survey data, Rofman and Oliveri (2012) studied active coverage rates in most countries in LAC since the early 1990s. Their analysis confirmed that active coverage rates have not increased significantly in the region remaining low regardless of the type of pension scheme analysed.

The number of those contributing to or affiliated with a pension scheme as a percentage of the active labour force went down from 42% in the early 1990s to around 32% in the 2000s and then went back up to 37% by the end of the decade. On average, active pension coverage fell in almost all of the countries of the region between the early 1990s and the early 2000s, i.e. the period during which most private pension schemes were implemented. The different financial crises inside and outside the region, the privatisation of public services and trade liberalisation are some of the reasons behind these trends. At the end of the 2000s, coverage of the economically active population was less than 30% in eight countries (Bolivia, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay and Peru) and above 60% in only three (Chile, Costa Rica and Uruguay).

There are, however, significant differences among countries. In particular, countries with the highest coverage rates at the beginning of the 1990s (such as Chile and Uruguay) continued to consolidate their pension systems, reaching today coverage rates close to 70%. Other countries, such as Peru and the Dominican Republic, have significantly increased their active coverage rates since the 1990s, even though they are still below 30%. In a third group of countries, such as Ecuador, Nicaragua, and Paraguay, the coverage rate continued to decline over the last two decades. No particular trend in coverage can be observed in the remaining set of countries.

Given the low levels of pension contributions, other elements of the current labour markets in Latin America and the weak impact of growth, it is likely that pension coverage will continue to be low in the future, thus presenting policy makers with one of the key challenges for economic and social policy.

22% of workers with eight years of education or less contribute to any pension scheme, compared to 42% of those who have between nine and 13 years of education, and 68% of those who have 14 years or more. Again, there are large differences between countries. For instance, in Bolivia, Paraguay and Peru, fewer than 5% of the least educated workers have a formal job, while this percentage is considerably higher in Costa Rica (60%) and Uruguay (54%). Moreover, the gap between the least and the most educated seems to be increasing over time in countries such as Colombia, Peru and Venezuela (Rofman and Oliveri, 2012).

The likelihood that a worker contributes also has a gender dimension. The average labour force participation rate for women in the LAC19 countries is 56% compared to 83% for men (which compare with OECD averages of 62% and 80% respectively). The gender gap ranges from 20% in Bolivia, Chile, Jamaica, and Uruguay to 40% in Guatemala, Honduras, and Mexico. Women generally report fewer years of formal employment than men because of career interruptions for child rearing and other caregiving responsibilities and of certain pension policies encouraging their earlier retirement. These facts combined with women's longer life expectancy imply that women on average spend longer periods in retirement with lower pensions, increasing the probability of female poverty in old-age. However, a comparison between Chile and Brazil (OECD, 2012) showed that a significant proportion of women working in different categories of informal employment in both countries have "indirect" pension coverage through their spouses' contributions, which entitle them to survivor pensions.

Women who participate in the labor market contribute very similarly to men in all countries. The most significant differences in LAC can be observed in Costa Rica where coverage is 12 percentage points higher for men and in Venezuela where it is 9% higher for women. Given the weak connection of women with the labor market in many Latin American countries, which translates into lower levels of coverage, non-contributory pensions can play a key role in reducing old-age poverty among women (OECD, 2011).

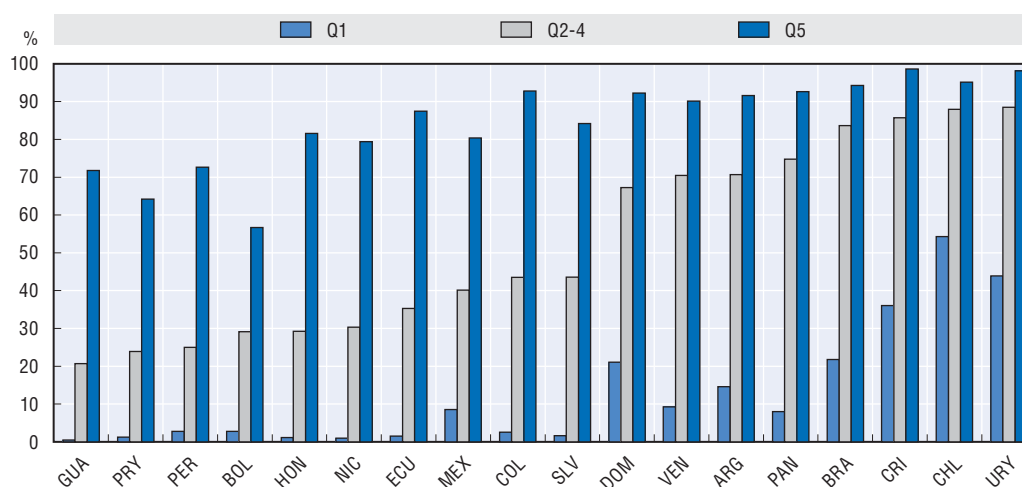
*Income differences* between households also have an important impact on the probability that people contribute. In all LAC countries, workers in the highest quintile (the 20% highest-income workers) have relatively high rates of contribution of between 80% and 98% in Costa Rica and Uruguay (see Figure 1.2). In contrast, low-income workers rarely contribute to pension schemes; their rates of contribution exceed 20% only in one-quarter of the sample (Brazil, Chile, Costa Rica, the Dominican Republic and Uruguay).

Middle-income workers defined in Easterly (2001) as workers in quintiles two to four that contribute to a pension scheme represent between 20 and 40% of total employment in half of the countries analysed (see Carranza et al., 2012 for an analysis of Colombia, Mexico and Peru). In these countries, the so-called emerging middle class seems particularly vulnerable to old-age poverty risks as they may not make enough contributions to qualify for a pension (see OECD, 2010; and Ferreira et al., 2013).

In relative terms, the gap in pension contribution rates between the lowest quintile and the middle class is largest in countries such as Argentina, Brazil, Panama, and Venezuela where it exceeds 55 percentage points. In the majority of the countries displayed in Figure 1.2, middle-income workers are very far from reaching the coverage rates of those in the highest quintile, and in half of the countries (including some of the biggest economies such as Colombia, Ecuador, Mexico and Peru), this difference exceeds 40 percentage points. The gap between the highest and lowest income quintiles is also very large, especially in Colombia, Ecuador and Panama. These figures highlight another important issue for policy makers in the decades to come – the potential impact of uneven pension coverage and contributions on income inequality.

Regardless of socioeconomic characteristics, the main determinant of pension coverage is the type of employment (as previously shown in Levy, 2008; Pagés, 2010; OECD, 2010; and Ribe et al., 2010). On average, while 64 out of 100 salaried workers contribute to a pension scheme in the LAC13 countries,<sup>5</sup> only 17 out of 100 self-employed workers do so (see Figure 1.3). Among the LAC13 countries, only Brazil, Chile, Costa Rica and Uruguay seem to be getting significant pension savings from the self-employed. Voluntary affiliation in some cases, a lack of enforcement despite mandatory affiliation in others, and the usual factors behind low pension savings (low and irregular income, myopia, and procrastination) explain this challenging situation.

Figure 1.2. **Contributors or affiliates as a percentage of total workers (aged 15-64 years) by income quintile, around 2010**



Note: The household survey data for Jamaica do not make it possible to control for income levels.

Source: Author based on Bosch, M., A. Melguizo and C. Pagés (2013), "Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean", Inter-American Development Bank, Washington, DC.


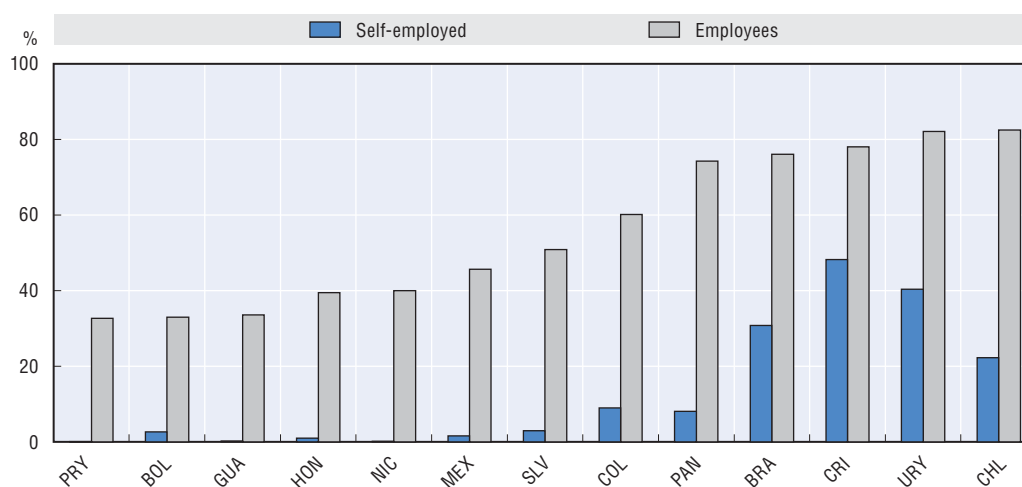
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Figure 1.3. **Contributors or affiliates as a percentage of total workers (aged 15-64 years) by type of employment, around 2010**



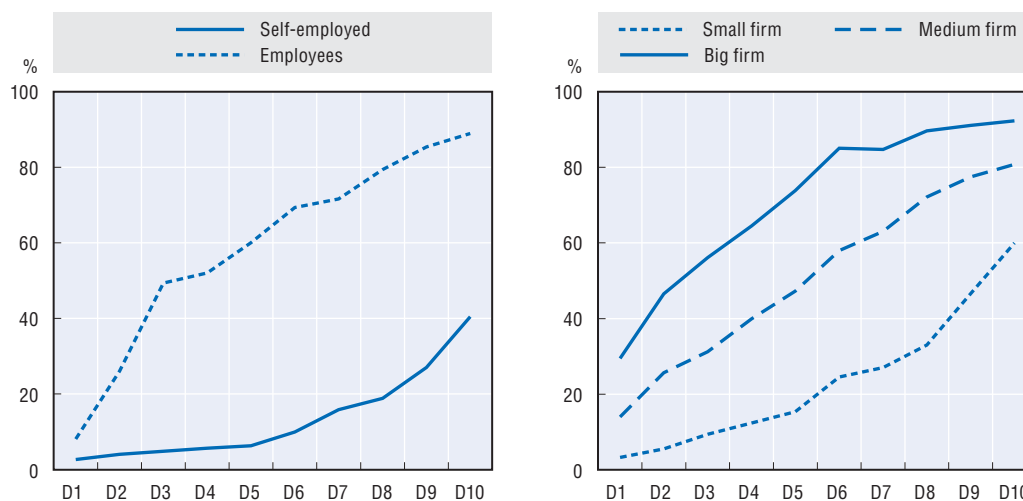
Note: The available data do not make it possible to differentiate contribution rates by occupation in Argentina, the Dominican Republic, Ecuador, Jamaica, Peru, and Venezuela.

Source: Bosch, M., A. Melguizo and C. Pagés (2013), "Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean", Inter-American Development Bank, Washington, DC.

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The size of the firm also plays an important role in the contributions of salaried workers. The larger the firm, the more employees tend to contribute, irrespective of their wage levels. In big firms with over 50 workers, 71% of salaried workers contribute, compared with 51% in medium-sized firms (with 6 to 50 workers) and 24% in small ones (with fewer than six workers). On average in the LAC19 countries, the share of middle-low-income workers (those in deciles 2 and 3) in big firms who contribute to a pension scheme is similar to the proportion of high-income self-employed or high-income salaried workers in small firms (see Figure 1.4). These workers face similar issues as the self-employed, particularly as related to enforcement.

Figure 1.4. **Contributors or affiliates as a percentage of total workers (aged 15-64 years) by income decile and occupation in LAC18, around 2010**



Note: Small firms employ two to five workers, medium firms employ 6 to 50, and big firms have over 50 employees. LAC18 represents the weighted average of Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Uruguay and Venezuela.

Source: Bosch, M., A. Melguizo and C. Pagés (2013), "Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean", Inter-American Development Bank, Washington, DC.

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The analysis so far has focused on static cross-sectional data that are publicly available from national household surveys. However, there is a widespread consensus that in LAC, as is the case in most emerging economies (Jütting and de Laiglesia, 2009), workers move frequently between formal and informal jobs and also between salaried jobs and self-employment. On average in the seven Latin America countries displayed in Table 1.1, 21% of formal workers moved into inactivity (5%), unemployment (3%), self-employment (4%), or directly into informal salaried jobs (9%) over a two-year period. In Colombia and Mexico, 25% of formal workers tend to move towards occupations with either less frequent or no contributions every year.

This high level of labour mobility shows the limitations of using cross-sectional household data since only longitudinal data make it possible to follow workers over time. Therefore, generally the household survey data in the region cannot be used, except with great caution, to proxy contribution histories over a worker's whole career. Fortunately, some countries publish and share research databases based on administrative records, which enable analysts to estimate contribution densities by looking at the share of time during which an affiliate has actively saved by making contributions to the pension scheme.

Table 1.1. **Circumstances of formal workers after one year**  
Percentages

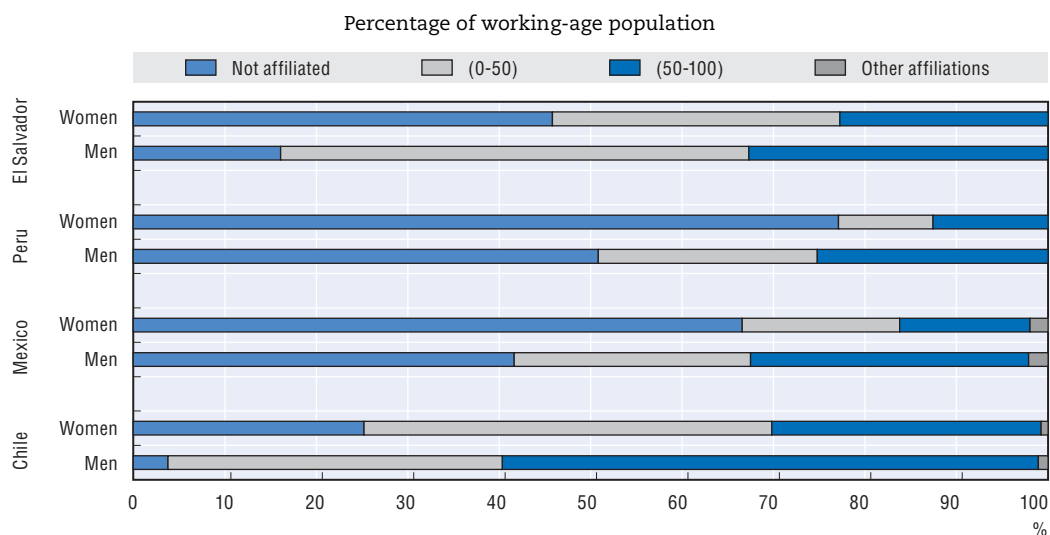
	Inactivity	Unemployment	Self-employment	Informal salaried workers	Formality
Colombia	6	7	4	9	75
Bolivia	3	2	3	11	81
Ecuador	3	1	4	7	85
Peru	3	3	7	8	79
Venezuela	5	3	7	7	77
Mexico	7	2	3	13	75
Argentina	5	3	2	7	83
<b>Average</b>	<b>5</b>	<b>3</b>	<b>4</b>	<b>9</b>	<b>79</b>

Source: Goñi, E. (2013), *Pandemic Informality*, Inter-American Development Bank, Washington, DC, for Colombia, Bolivia, Ecuador, Peru, and Venezuela; Pagés, C. and M. Stampini (2009), “No Education, No Good Jobs? Evidence on the Relationship between Education and Labor Market Segmentation”, *Journal of Comparative Economics*, Vol. 37, No. 3, pp. 387-401, for Argentina; and Bosch, M. and W.F. Maloney (2006), “Gross Worker Flows in the Presence of Informal Labor Markets. The Mexican Experience 1987-2002”, *Discussion Paper No. 0753*, Centre for Economic Performance, London School of Economics & Political Science, London, for Mexico.


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As shown in Figure 1.5, in Chile, El Salvador, Mexico, and Peru, an unweighted average of over 40% of the working-age population is not affiliated to any pension scheme. This is driven by significantly lower female labour participation compared to men (for example, only 23 out of 100 working-age women in Peru are affiliated). Administrative records suggest that contributions are even lower and more irregular among the affiliated. According to these official records, more than half of the affiliates in these four Latin American countries contribute for less than six months each year. Among women, this share of low-density affiliates rises to 55%, with the largest share being in Chile where 60% of women affiliated with the pension system have contributed for less than 50% of the time.

Figure 1.5. **Affiliation and contribution densities by gender in Chile, Mexico, Peru and El Salvador**



Source: Bosch, M., A. Melguizo and C. Pagés (2013), “Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean”, Inter-American Development Bank, Washington, DC, based on Forteza, A., I. Apella, E. Fajnzylber, C. Grushka, I. Rossi and G. Sanroman (2009), “Work Histories and Pension Entitlements in Argentina, Chile, and Uruguay”, *Social Protection Discussion Papers No. 52446*, World Bank, Washington, DC, for Chile; Argueta, N. (2011), “Entre el individuo y el Estado: condicionantes financieros del sistema de pensiones en El Salvador”, Fundaungo, San Salvador, for El Salvador; and official data for Mexico and Peru.

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In summary, both the household survey data and administrative records show that LAC countries are far from having workers contribute regularly. Therefore, in order to be realistic in terms of predicting outcomes, any simulations of future pension entitlements should incorporate scenarios with less than complete contribution careers. The next section will present some estimates using the OECD pension models and some stylised work histories as well as estimates from official records.

### Future adequacy of retirement incomes

The contribution gaps of LAC men and women, correlated with high transition rates, high shares of informality, and low employment rates, will have a significant impact on the future adequacy of retirement incomes. In almost all systems, incomplete contribution histories result in lower pension entitlements.

- In defined-contribution schemes, periods without contributions in the early years of a worker's career have a particularly negative impact given the effect of compound interest.
- In defined-benefit systems, if gaps are prolonged or are concentrated at the end of the working life, some workers may not reach the required number of years of contributions to receive even the minimum contributory pension.

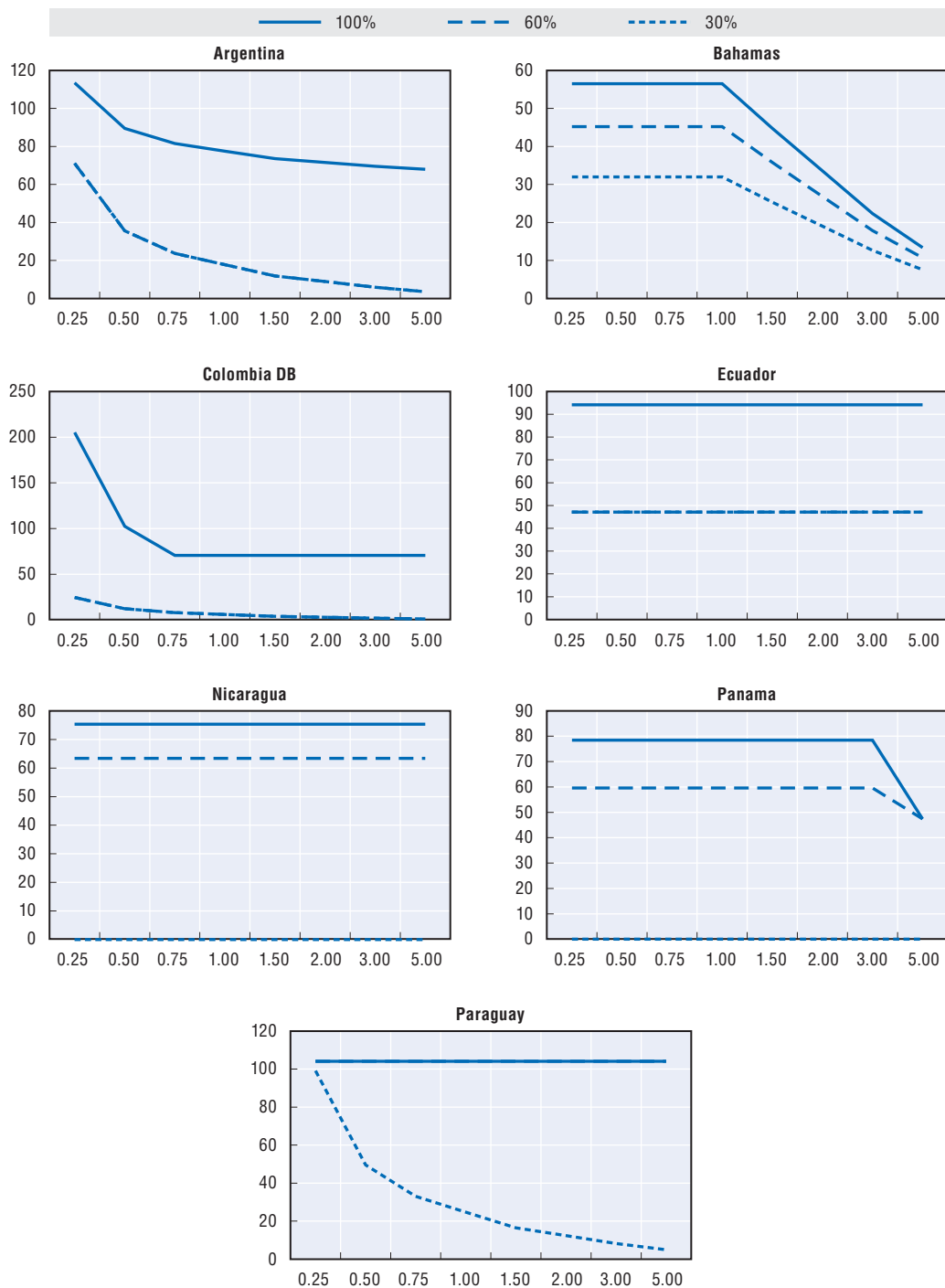
Therefore, it is important to examine not only the size of these contribution gaps but also their distribution over time. The analysis of data from two pilot surveys carried out by the Inter-American Development Bank (IDB) in 2008 for Lima (Peru) and Mexico City (Mexico) suggests, for example, that gaps tend to be distributed evenly during a working life, which is consistent with the frequent labour transitions discussed above. In Lima and Mexico City, workers aged 55 to 59 years old contribute to the pension schemes for an average of 18 and 17 years, respectively. Assuming that these workers entered the labour market at age 20, their average contribution densities may be estimated to be about 48 and 47%, respectively.

However, these results should be taken only as rough proxies of contribution densities since they just reflect a self-reported cross-section, taken in 2008, of the whole contribution history of every worker in the survey. Also, only a few countries in the region (e.g. Chile and Mexico) have sufficient administrative data to construct the entire contribution history. This highlights the need for better and longer panel data as job mobility may be part of a worker's longer-term plan and thus may not be evident in the short-term data.

To address this issue, Figures 1.6 and 1.7 illustrate a key pension indicator, the net pension replacement rate, for workers with different stylised contribution densities. Given the lack of real contribution histories for the majority of countries and the imperfections of cross-sectional data, the figures illustrate three stylised profiles for male workers: i) formal workers (100% density of contributions, which is representative of high-income workers in most countries); ii) workers with 60% contribution densities (close to average in less informal countries such as Argentina, Chile, Panama, and Uruguay); and iii) workers with 30% contribution densities (the average in more informal countries such as Colombia, the Dominican Republic, Ecuador, El Salvador and Mexico). Contribution gaps are assumed to be evenly distributed with age, in line with the results for Mexico City and Lima/Peru.



Figure 1.6. Replacement rates by wage level in selected defined-benefit pension schemes



Note: See Chapter 3 below for an explanation of the assumption of the OECD pension models. The X axis refers to wage as multiple of average wage and the Y axis refers to the percentage of own wage.

Source: OECD pension models.


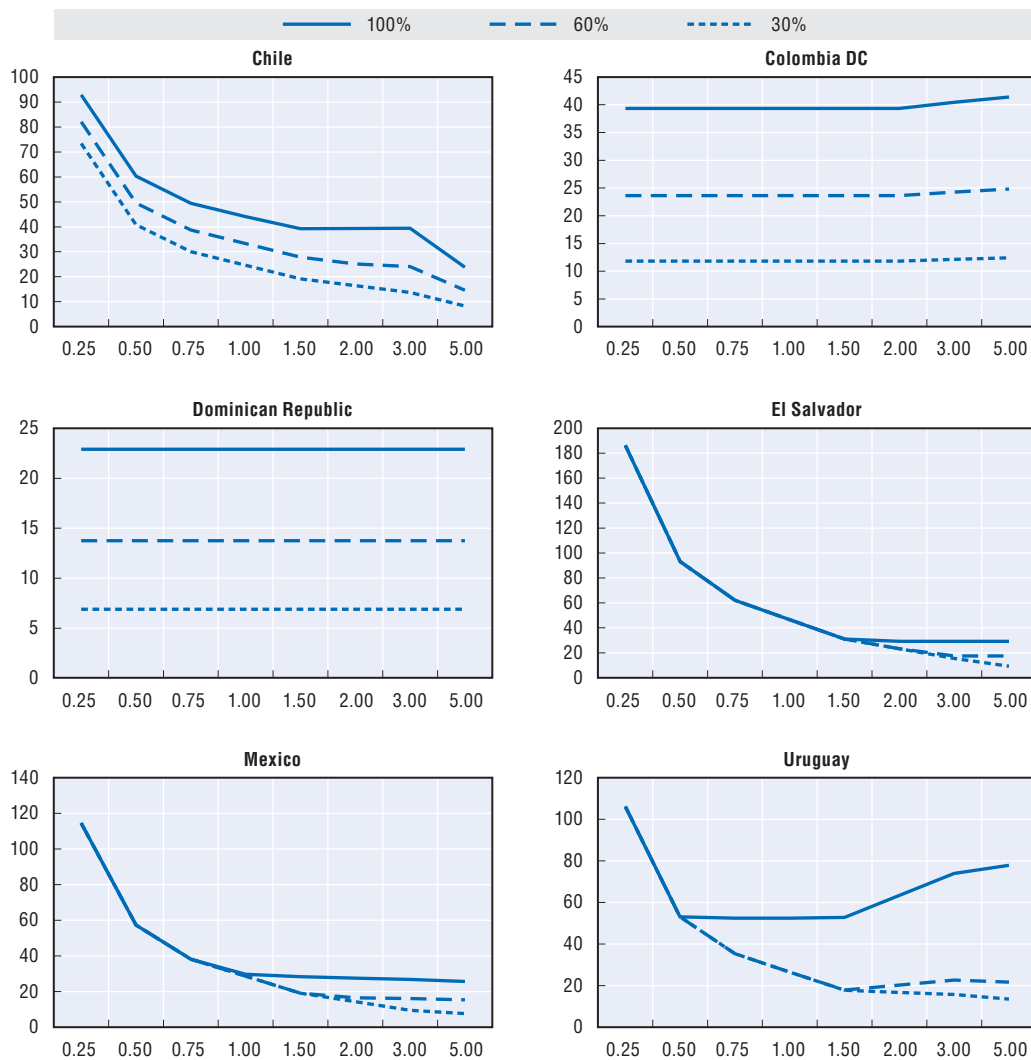

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Figure 1.7. Replacement rates by wage level in selected defined-contribution and mixed pension schemes



Note: See Chapter 3 below for an explanation of the assumption of the OECD pension models. The X axis refers to wage as multiple of average wage and the Y axis refers to the percentage of own wage.

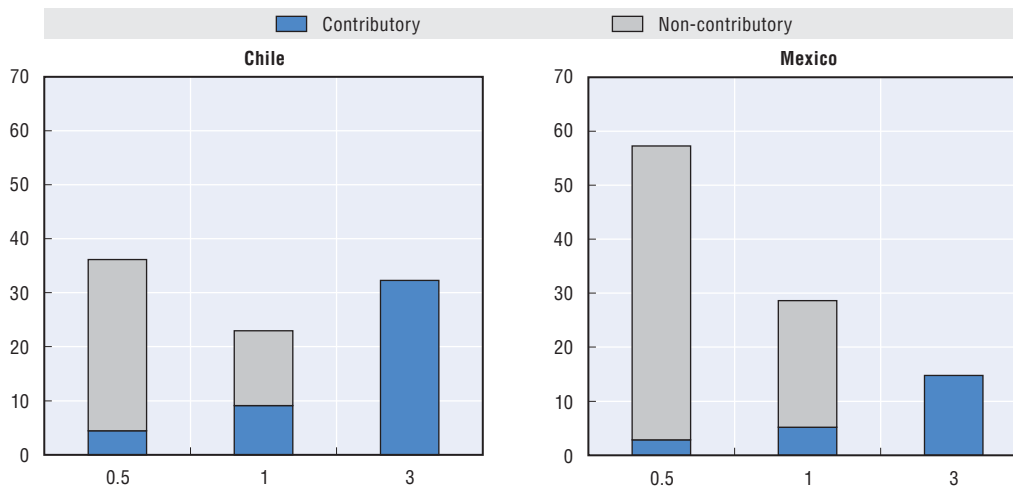
Source: OECD pension models.

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Figures 1.6 and 1.7 show very significant differences between these categories that are especially large in defined-benefit systems when workers are not eligible for minimum contributory pensions because of low densities (for example, in Nicaragua and Panama). In defined-contribution schemes, replacement rates tend to be lower given that they reflect only contributions and financial returns (whereas defined-benefit systems may incorporate some implicit subsidies). Meanwhile, defined-benefit schemes have minimum vesting rules that can lead to not having a pension even after having contributed for several years. For instance, in Mexico's old defined-benefit system workers who contributed for fewer than ten years received no benefits at all. Finally, net replacement rates were simulated by combining administrative data on densities and wage levels for Chile and Mexico (Figure 1.8). The results suggest that workers who earn half of the minimum wage in both countries have contribution densities of 13% and 8% respectively, much lower than


those who earn either the average wage (24% and 17% respectively) or three times the average wage (82% and 55% respectively). Because of the non-contributory components in some of these countries, net replacement rates for these low-wage low-density workers can be above 50%.<sup>6</sup> Considering only the contributory components, the net replacement rates barely reach 10 to 15% for low-income and middle-income workers respectively. Finally, the net pension replacement rates for high-income workers (who would not benefit from the targeted non-contributory components) range between 15 and 32%, and these differences would be much bigger in absolute terms.

Figure 1.8. **Replacement rates by wage level in Chile and Mexico**



Note: The X axis refers to wage as multiple of average wage and the Y axis refers to % of own wage.

Source: Authors' own calculations.

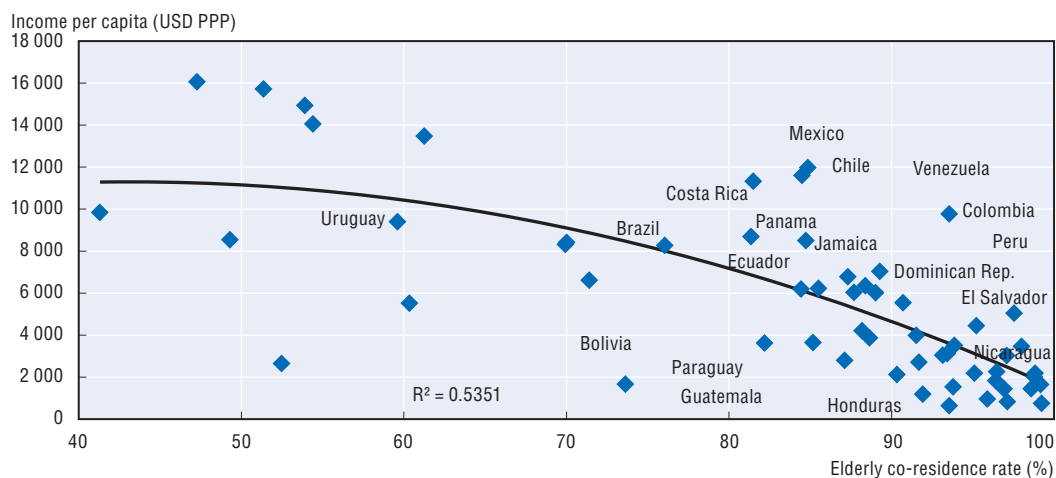
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## Economic well-being of the elderly

Growing concern about the effects of limited coverage on the current and future adequacy of pensions in the region must be viewed in the broader context of the economic well-being of older people in general. A large share of older people in LAC will have to rely on other sources of income than contributory pensions. This includes work income, assets such as housing,<sup>7</sup> informal transfers, and support within households and families and from government programmes such as social pensions (discussed in more detail below).

An important starting point for the analysis of the economic well-being of the elderly is their household structure. Figure 1.9 plots the relationship between per capita income (in USD PPP) and co-residence – which is defined as a person aged 60 or older living with family members other than a spouse. While there is a strong (negative) relationship between income level and the likelihood that an elderly person will be living with a family member, there are nevertheless significant variations between countries with similar income levels. Chile and Mexico are clear outliers with high incomes and high co-residence rates.

In addition to the cross-country pattern, the income/co-residence relationship also applies within countries with the lower part of the income distribution having higher co-residence rates, as shown in Table 1.2. Most of the elderly poor in Latin America live in multi-generational households suggesting that the welfare of the vast majority of the

Figure 1.9. **Comparison of co-residence rates in Latin American countries**

Note: This figure includes 55 countries.

Source: Calculations based on ASPIRE Household Survey Data, World Bank Database.

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region's elderly who receive no formal pension income is closely tied to that of their family. At the same time, evidence of intra-household allocation of resources is scarce and little is known about the relative consumption of the elderly in this regard.

The long-term trends of increased urbanisation and lower fertility will also reduce the chances of this kind of family support being available in the future implying that the limitations of the formal pension system will become increasingly important. However, well-targeted programmes such as cash transfers aimed at poor households have the potential to reach most of the elderly poor.<sup>8</sup>

Table 1.2. **Co-residence rates by quintile in LAC**

Percentages

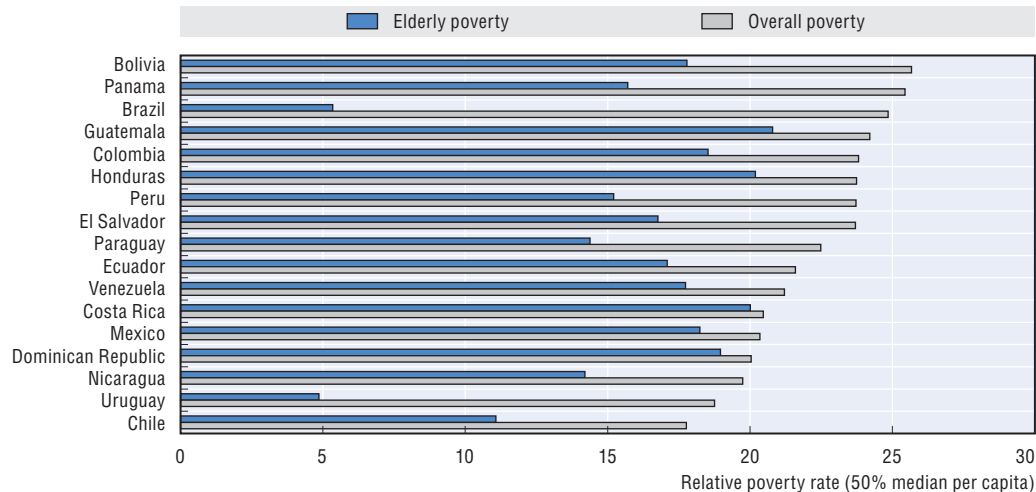
	Poorest	2	3	4	Richest
Argentina	68	56	42	47	40
Bolivia	79	54	68	66	64
Brazil	85	59	59	57	55
Chile	79	65	61	64	57
Colombia	74	81	84	75	61
Costa Rica	67	55	70	73	65
Dominican Republic	87	78	75	75	65
Ecuador	64	70	70	68	60
El Salvador	81	84	80	74	69
Guatemala	78	80	84	78	75
Honduras	85	84	85	82	77
Mexico	66	72	71	69	65
Nicaragua	95	92	92	87	78
Panama	68	76	68	65	51
Paraguay	74	82	80	72	67
Peru	70	73	71	73	66
Uruguay	64	42	40	33	27
Venezuela	80	88	86	85	73

Source: Calculations based on ASPIRE Household Survey Data, World Bank Database.

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There is little evidence that the elderly are poorer than the non-elderly. Figure 1.10 shows that relative poverty rates at the individual level are lower for the elderly in all of the countries where data are available. The most dramatic differences are in countries with large social pension programmes such as Bolivia and Brazil or where there is high coverage of the contributory pension scheme as in Chile and Uruguay.

Figure 1.10. **Relative poverty rates of the elderly and non-elderly in Latin America**



Source: Calculations based on ASPIRE Household Survey Data, World Bank Database.


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Table 1.3 compares elderly and non-elderly households to see which are more likely to be found in the bottom two quintiles of the distribution. The table shows that in most countries the elderly are less likely to live in households in the bottom two quintiles of the income distribution than in households in the higher quintiles. However, it also shows that the results of such comparisons can be very sensitive to assumptions regarding how size and composition of the household affects welfare. An important adjustment often made in the literature is an adult equivalence scale which assumes that children have lower consumption needs. Another important adjustment that is sometimes made to ensure valid inter-household comparisons is to take into account the economies of scale involved in household consumption. To the extent that some consumption is shared, a larger household may not consume as much per capita as a smaller household and yet may enjoy the same living standard. Intuitively, there are certain fixed costs involved in a household of whatever size, meaning that additional members make little difference to the household's overall consumption.

In Table 1.3, the first and fourth columns show the share of elderly and non-elderly households in the bottom 40% of the distribution without adjusting for household composition or size. The rates are also shown for both groups adjusted for the composition and size of the household. In general, the results show that, even with these adjustments, households with elderly members are less likely to be in the bottom two quintiles of the distribution than households with no elderly members.<sup>9</sup> The most important exceptions are Costa Rica and the Dominican Republic. In three countries, the difference is marginal, and in two-thirds of the countries – Argentina, Bolivia, Brazil, Colombia, El Salvador,


Honduras, Nicaragua, Paraguay, Uruguay and Venezuela – the advantage held by elderly households over households with no elderly members is significant. Brazil stands out because elderly households are less than half as likely to be found in the bottom two quintiles as households with no elderly members. This is undoubtedly due to a large extent to the high level of spending on Brazil’s rural pension scheme (see below) as well as the high coverage of formal sector workers by contributory pensions. The Brazilian example is an extreme case where spending on rural pensions is three times as much as the more well-known “Bolsa Familia” targeted to poor households. The latter programme disproportionately benefits children. In each country, the allocation of scarce budget resources raises the question of this type of tradeoff.

Table 1.3. **Households with or without elderly members in the bottom 40%**

	Any elderly – unadjusted	Any elderly – economies of consumption	Any elderly – economies of scale	No elderly – unadjusted	No elderly – economies of consumption	No elderly – economies of scale
Argentina	0.302	0.277	0.314	0.433	0.443	0.43
Bolivia	0.357	0.34	0.368	0.411	0.414	0.407
Brazil	0.228	0.211	0.222	0.451	0.456	0.453
Colombia	0.37	0.358	0.36	0.411	0.416	0.414
Costa Rica	0.41	0.389	0.425	0.397	0.403	0.392
Dominican Republic	0.436	0.415	0.443	0.387	0.395	0.385
Ecuador	0.381	0.363	0.389	0.406	0.413	0.404
El Salvador	0.363	0.348	0.36	0.416	0.422	0.417
Guatemala	0.397	0.394	0.401	0.4	0.401	0.4
Honduras	0.402	0.393	0.405	0.399	0.402	0.398
Nicaragua	0.351	0.344	0.349	0.421	0.423	0.421
Paraguay	0.364	0.343	0.361	0.411	0.418	0.413
Uruguay	0.283	0.254	0.309	0.46	0.474	0.446
Venezuela	0.369	0.36	0.363	0.411	0.414	0.413

Note: The cutoff is set at 40% of the welfare distribution. The assumption is that the consumption of the elderly and youth is 75% of that of adults. Economies of scale are assumed to be 0.7. The shading indicates the poorest group.

Source: Calculations based on ASPIRE Household Survey Data, World Bank Database.

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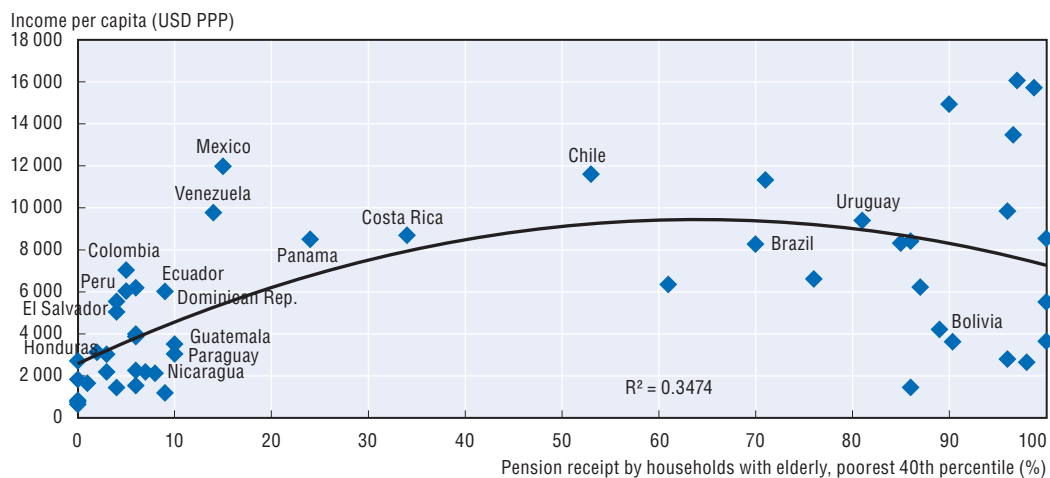
## Pensions and retirement incomes

As would be expected given the evidence presented earlier regarding coverage, the importance of pensions in the incomes of households with elderly members varies widely across the region. However, in most countries, they play a relatively limited role in poor households. The exceptions are countries with very high coverage rates and those that rely heavily on non-contributory or social pensions.


Figure 1.11 shows the relationship between the percentage of elderly households in the bottom 40% of the distribution that receive any pension income and per capita income (in USD PPP) in 55 countries around the world. There is clearly a positive relationship between income and the coverage of low-income households across the sample, but the correlation is not high. This is due to the fact that while contributory pension coverage is higher the richer the country, social pension policies can increase the coverage among the bottom part of the income distribution even in poor countries. The same is true for LAC countries, with Venezuela and the Dominican Republic having much lower coverage than other countries at the same income level.<sup>10</sup> In contrast, Bolivia stands out as having much

higher coverage than other countries with a similar income level such as Honduras and Nicaragua. Coverage in Bolivia measured in this way is likely to have increased further in the last few years since the data point does not reflect the most recent change in the *Renta Dignidad* programme that reduced the eligibility age from 65 to 60. Several countries are outliers in that the share of elderly in the bottom 40% receiving pensions is relatively low given its income level. Interestingly, and as discussed in the next section, some of these countries are now in the process of introducing or expanding their social pension schemes.<sup>11</sup>

Figure 1.11. **Share of the elderly in the bottom two quintiles who receive a pension**



Source: Calculations based on ASPIRE Household Survey Data, World Bank Database.

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## Social pensions

The expansion of non-contributory pensions (also known as “social pensions”) or cash transfers targeted to the elderly is a global phenomenon<sup>12</sup> but nowhere has it been more dramatic than in Latin America. Rofman et al. (2013) documented this recent phenomenon for ten countries in the region that together represent more than 90% of the population of LAC. Table 1.4, which is based on this study, traces the most important policy changes over the last two decades and clearly shows the recent pattern of expansion of these non-contributory programmes.

The programmes are all aimed at increasing the share of the elderly population receiving government transfers but have taken various forms. Bolivia pays a universal pension although with some reduction for those receiving contributory pensions. Venezuela makes eligibility contingent on not receiving a contributory pension as does Mexico. In Argentina, eligibility restrictions for contributory pensions were relaxed for certain cohorts but the change is temporary.<sup>13</sup> Finally, in Chile, the social pension is integrated with the contributory pension with the aim of reducing incentives not to contribute to evade the defined-contribution scheme (see Box 1.2). These variations in social pension design imply significant differences in cost and incentives.

Table 1.4. **Expansion of non-contributory pensions in LAC, 1990-2013**

1990-2001	2001-07	2008-13
<b>Brazil (1991):</b> FUNRURAL pension age is reduced to 60 for men and 55 for women	<b>Argentina (2003):</b> Advance old-age pension was established	<b>Bolivia (2008):</b> <i>Renta Dignidad</i>
<b>Guyana (1993):</b> Old-age pension became universal	<b>Belize (2003):</b> Non-Contributory Pension Programme (NCP)	<b>Chile (2008):</b> <i>Pension Basica Solidaria de Vejez</i>
<b>Bolivia (1996):</b> Bonosol	<b>Colombia (2003):</b> PPSAM Social Protection Programme for Older People	<b>Ecuador (2009):</b> Pension for Older People becomes universal
	<b>Ecuador (2003):</b> Pension for Older People	<b>El Salvador (2009):</b> Universal Basic Pension
	<b>Guatemala (2005):</b> Economic Contribution Programme for Older People	<b>Panama (2009):</b> <i>100 a los 70</i>
	<b>Mexico (2007):</b> <i>70 y más</i>	<b>Argentina (2010):</b> The state provides a life-long pension equal to 70% of the minimum pension or ARS 832.64/month
		<b>Peru (2011):</b> Pension 65
		<b>Mexico (2012):</b> <i>70 y mas</i> was extended to localities with more than 30.000 inhabitants
		<b>Colombia (2012-13):</b> Extension to all citizens over 65 without pension benefits living in poor rural areas
		<b>Mexico (2013):</b> Change from <i>70 y más</i> to <i>65 y más</i> and announced shift to universality

Source: Authors based on Rofman, R., I. Apella and E. Vezza (2013), "Mas Allá de las Pensiones Contributivas: Catorce Experiencias en América Latina", World Bank, Washington, DC.

### Box 1.2. **Integrating non-contributory and contributory pensions: Chile's new solidarity pillar**

Chile introduced a new solidarity pillar in 2008 that would complement the existing contributory pension system based on individual capitalisation. In 1981, Chile had replaced its traditional defined-benefit PAYG pension system with a defined-contribution system with individual accounts managed by specialised private firms. Two types of non-contributory benefit existed: i) a social assistance pension targeted to the lowest income quintile of the population with eligibility precluded if there was any other source of pension; and ii) a minimum pension guarantee for pension fund contributors that had attained only low balances after at least 20 years of contributions.

By 2006, it was clear that, although the system had been very successful in obtaining high real rates of returns for the pension funds, pension levels would not be adequate for a large portion of the population. Most members of the system did not contribute frequently enough to build a large balance. Although the proportion of the labour force that worked in the formal sector was relatively high at around 60%, only a minority held steady jobs in the formal sector. Bernstein et al. (2006) estimated that around 50% of members would receive a pension lower than the minimum pension, and many would not reach the 20 years of contributions required for the pension guarantee. On the other hand, many of these individuals would not be poor enough to qualify for the social assistance pension. As a result, low- to middle-income individuals fell into a coverage gap.

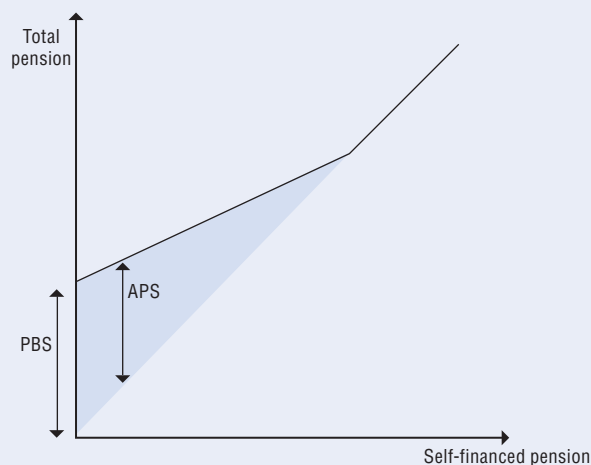


**Box 1.2. Integrating non-contributory and contributory pensions:  
Chile's new solidarity pillar (cont.)**

In order to increase pension levels, the government followed a dual strategy by: i) expanding contributory coverage so that anyone who is able to save makes pension contributions; and ii) providing a non-contributory minimum pension level and a supplement for low pensions through a new solidarity pillar.

Measures to expand the contributory base included gradually introducing mandatory contributions for the self-employed through the tax system, strengthening enforcement, and creating incentives for workers to make voluntary contributions. With regard to non-contributory benefits, Chilean policy makers faced a trade-off between providing income protection and reducing incentives to save. The new solidarity pillar had to be designed in a way to be compatible with incentives to contribute in the system. Since neither the existing social assistance pension nor the minimum pension guarantee provided adequate income support to alleviate poverty in old age, it was decided that the new pillar would replace both programmes. In order to maintain some incentives to contribute, the benefit was designed not as an absolute minimum floor guarantee but as a minimum pension for individuals with no contributions plus a top-up for individuals with contributions. The amount of the top-up would be reduced depending on the level of the contributory pension. The reduction was designed so that the total pension (the sum of the contributory and non-contributory pensions) would always be increasing along with the balance accumulated in the individual account. In other words, the new solidarity pillar was designed as a minimum pension benefit with a “clawback” as shown in the diagram below. The amount of the minimum benefit was set at a level above the existing social assistance pension (but below the minimum pension guarantee), and the clawback rate was set at a level close to 30%. Operationally, the new solidarity pillar was composed of two benefits: i) the basic solidarity pension (PBS) for individuals with no contributions and ii) a solidarity pension supplement (APS), which is the top-up for individuals with some contributory pension. The target population for the new benefits would be individuals aged 65 years or older who belonged to the 60% poorest households and had a minimum of 20 years of residency in the country. Thus, the minimum benefit went from being a targeted poverty alleviation programme to a broad programme aimed at excluding the most affluent, and the contribution requirement was replaced by a residency condition.

**Clawback in the solidarity pillar**



In addition to differences in coverage and eligibility rules, benefit levels vary widely, resulting in significant differences in costs as shown in Table 1.5.


Table 1.5. **Social pensions in Latin-American countries**

Programme		Eligibility conditions				Coverage and adequacy		
		Targeting			Qualifying conditions			
		Means tested/ Poverty targeted	Pension/ benefit test	Geographically targeted	Age	Beneficiaries/ 65+ pop.	Benefit/ Income per capita	Social pension wealth/GDP per capita
Argentina	Pensiones Asistenciales	y	y	n	70	1.8%	25.0%	1.7
Bahamas	Old Age Non-Contributory Pension	y	y	n	65	..	..	1.7
Barbados	Non-contributory Old Age Pension	y	y	n	65 + 6 m	30.1%	23.3%	2.9
Belize	Non-Contributory Pension Programme	y	y	n	67/65	30.0%	12.5%	1.9
Bolivia	Renta Dignidad	n	n	n	60	91.0%	12.6%	2.4
Brazil	Previdencia Rural	n		y	60/55	86.0%	17.2%	5.0
	Beneficio de Prestacao Continuada	y	y	n	65	12.0%	33.0%	..
Chile	Pension Basica Solidaria de Vejez	y	y	n	65	83.0%	12.0%	2.1
Colombia	PPSAM	y	y	y	57/52	44.0%	4.3%	1.0
Costa Rica	Regimen No Contributivo	y	y	n	65	59.0%	17.8%	3.2
Dominican Republic	Nonagenarios	y	y	n	60	..	n.a.	3.0
Ecuador	Pension para Adultos Mayores	y	y	n	65	56.0%	7.7%	1.8
El Salvador	Pension Basica Universal	y	y	y	70	17.0%	12.2%	2.2
Guatemala	Aporte economico del Adulto Mayor	y	y	n	65	16.0%	18.0%	2.8
Guyana	Old Age Pension	n	n	n	65	151.0%	18.0%	2.4
Haiti	Not applicable							
Honduras	Not applicable							
Jamaica	PATH	y	y	n	60	24.0%	2.0%	0.5
Mexico	65 y mas	n	y	y	65	63.0%	5.0%	0.6
Nicaragua	Not applicable							
Panama	100 a los 70	n	y	n	70	81.0%	12.6%	1.7
Paraguay	Pension alimentaria	y	y	n	65	29.0%	29.3%	4.4
Peru	Pension 65	y	y	y	65	41.0%	8.6%	1.3
Suriname	Not applicable							
Trinidad and Tobago	Senior Citizen Pension	y	y	n	65	99.0%	30.5%	4.6
Uruguay	Pensiones no contributivas	y	y	n	70	7.0%	22.0%	3.3
Venezuela, RB	Gran Mision Amor Mayor	y	y	n	60/55	23.0%	18.0%	6.9

y: yes; n: no; ..: not available.

Note: Social pension wealth is the present value of the stream of payments at current levels from eligibility age until death based on country specific mortality tables.

Source: Rofman et al. (2013), *Social Pension Database HelpAge*, Household Surveys and author's calculations.

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In six countries, social pension recipients represent more than one-half of the population aged 65 and over. In Bolivia, Guyana, and Suriname, social pensions are essentially universal.<sup>14</sup> In contrast, social pensions are clearly marginal in El Salvador, Paraguay, and Peru and do not exist at all in Haiti, Honduras, and Nicaragua. Benefit levels also vary widely. Benefits range from only 3% of national per capita income in Jamaica to more than 40% in Venezuela. Comparing the relative generosity of social pensions is complicated by the different expected durations of retirement between countries, which are determined by life expectancy at the age at which a worker becomes eligible for the social pension. One way to capture this is by calculating the present value of social pension payments from the age of eligibility until death taking into account country-specific

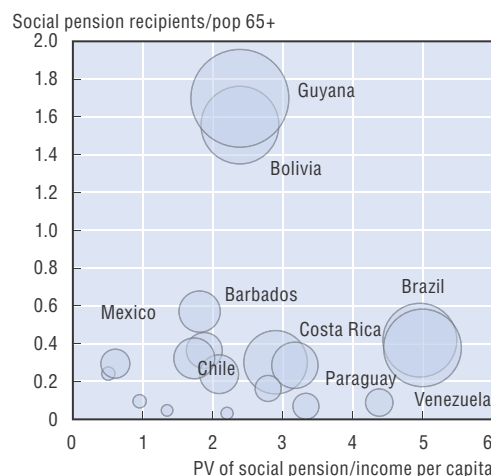
mortality patterns. The last column of Table 1.5 shows the present value of benefits. This takes into account not only the differences in benefit levels but also the differences in life expectancy at the age of eligibility. By this measure, Venezuela has by far the most generous social pension, followed by Suriname and Brazil. While Bolivia, Guyana, and Suriname all have universal pensions, the social pension wealth indicator suggests that Suriname's relative benefit level is twice as generous as that of the other two countries.

Combining the social pension wealth indicator with the coverage rate makes it possible to compare social pensions in different countries. Figure 1.12 below maps the social pension programmes in the region in three dimensions – pension wealth is on the x axis, coverage is on the y axis, and the size of the circle is proportional to the expense of the programme. This is calculated by projecting spending through to 2040 and dividing the present value by current GDP.<sup>15</sup>

The figure shows that, in terms of coverage and relative generosity, social pensions are most important in Guyana and Bolivia, followed by Venezuela and Brazil. Although not shown on the figure, Suriname and Trinidad are also among the largest social pension programmes in the region, and Trinidad's ageing projections suggest that it will be among the most expensive. These last two will also be the most expensive because their populations will age more rapidly in the next two decades. The Government of Mexico recently announced that it would further extend coverage and double benefits; while the full implementation of Chile's new social pension will increase its coverage over the next few years. Social pensions play a much less prominent role in the rest of the region.<sup>16</sup>

Figure 1.12 makes it possible to make comparisons between countries by abstracting from their different demographic situations. These differences are quite large. The proportion of the population aged 65 and above is around 14% in Uruguay but less than 5% in Bolivia. As the younger populations begin to age, countries with large social pensions (according to the indicator in Figure 1.12) can expect large spending increases unless the programmes become more targeted or less generous.

Figure 1.12. **Social pensions in Latin American countries**



Note: Pension wealth is on the x axis, coverage is on the y axis, and the size of the circle is proportional to the expense of the programme.

Source: Rofman, R., I. Apella and E. Vezza (2013), "Mas Allá de las Pensiones Contributivas: Catorce Experiencias en América Latina", World Bank, Washington, DC, and HelpAge International.

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In summary, the role of social pensions is expanding in Latin America and the Caribbean, and, in some countries, they are already a major element of the pension system. While social pensions can help to fill the coverage gaps in the region's contributory pension schemes, the more extensive and generous programmes will present policy makers with a fiscal challenge as the population ages.

## Conclusion

This chapter has focused on the coverage of formal pension systems, both in terms of active workers that contribute as well as the elderly that receive pensions, increasingly from non-contributory pensions. Coverage is an issue with a high priority in the region today and the gaps arise from a number of factors including:

- non-compliance or informal labour activity that precludes participation contributory pension schemes
- low contribution density which, in turn, affects the adequacy of future pensions for many individuals, especially those with low incomes
- current elderly whose lack of pension income reflect these first two dimensions but in the past
- the role and coverage of social pensions, i.e. cash transfers to the elderly that are not tied to contributory pension schemes.

The countries in Latin America and the Caribbean are attempting to address the coverage issue in different ways but the most evident trend and the policy that appears to be having the most impact is the extension of social pensions. In addition to its impact on coverage, this policy shift has important long term fiscal implications in these aging countries. It also affects the analysis of adequacy that is the subject of the rest of this report. For example, in countries like Bolivia, where the social pension is the only source of income for the vast majority of the elderly, the design of the contributory scheme is less relevant for assessing the adequacy of the system and for making international comparisons. At the same time, countries that are adopting social pension schemes that will complement the pension income of some workers receiving a contributory pension, as in Chile, must now pay closer attention to the implications of this approach for adequacy.

## Notes

1. This term is equivalent to pension contribution rate in the book Bosch et al. (2013).
2. Informality has been defined using different criteria. According to Enste and Schneider (2000), informal activity is defined as all economic activities in unregistered enterprises that contribute to the gross national product (GNP). Informality has also been defined in terms of the occupation (as consisting of own-account workers and unpaid family workers) or by the size of the unit of production (ECLAC, 2008). Other international organisations have defined informal workers as those who do not benefit from social security and are not protected by labour regulations (ILO and WTO, 2009; and OECD, 2010, in case of lacking a written contract). This section will follow the definition used by Bosch et al. (2013) in which formal sector workers are those who make contributions to any pension scheme.
3. Argentina: Encuesta Permanente de Hogares – Continua (EPHC), 2010; Bolivia: Encuesta de Hogares (EH), 2009; Brazil: Pesquisa Nacional por Amostra de Domicilio (PNAD), 2011; Chile: Encuesta CASEN (CASEN), 2011; Colombia: Gran Encuesta Integrada de Hogares (GEIH), 2010; Costa Rica: Encuesta de Hogares de Propósitos Múltiples (ENAHO), 2010; Dominican Republic: Encuesta Nacional de Fuerza de Trabajo (ENFT), 2010; Ecuador: Encuesta Periódica de Empleo, Desempleo y Subempleo (ENEMDU), 2010; El Salvador: Encuesta de Hogares de Propósitos Múltiples (EHPM), 2010; Guatemala: Encuesta Nacional de Empleo e Ingresos (ENEI), 2010; Honduras: Encuesta de

Hogares Permanente de Propósitos Múltiples (EPHPM), 2010; Jamaica: Labor Force Survey (LFS), 2010; Mexico: Encuesta Nacional sobre Ingresos y Gastos de los Hogares (ENIGH), 2010; Nicaragua: Encuesta Continua de Hogares (ECH), 2010 ; Panama: Encuesta de Hogares (EH), 2010; Paraguay: Encuesta Permanente de Hogares (EPH), 2010; Peru: Encuesta Nacional de Hogares (ENAHO), 2010 ; Uruguay: Encuesta Continua de Hogares (ECH), 2010; and Venezuela: Encuesta de Hogares por Muestreo (EHPM), 2010); Colombia: GEIH

4. These are data on contributions when available (in Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Venezuela and Uruguay). Some countries only have data on contributions made by salaried workers (Argentina, Ecuador, Paraguay, Peru, the Dominican Republic and Venezuela). In the rest, the figures relate to affiliation with a pension scheme. This distinction has important implications. Affiliates or members are those who at some time registered for the pension system but who may or may not have continued contributing. Meanwhile, the term contributors refers only to those who are contributing to the system at a specific moment in time. Many of the affiliates do not make contributions regularly, meaning that they may not be eligible to receive pension benefits in the future.
5. Data are not readily available for the whole sample of countries.
6. Non- contributory pensions supplement the contributory pension or establish a minimum pension level.
7. See *Pensions at a Glance 2013: OECD and G20 Countries (2013a)* for a discussion of the role of home ownership. The same section shows that the elderly are substantially more likely to own their homes than younger household heads.
8. For example, Behrman and Parker (2013) have shown the benefits of the targeted cash transfer programme to the elderly poor in Mexico.
9. The combination of both types of adjustment is not shown because the results remain similar.
10. It is interesting to note that in 2012, Venezuela introduced a new social pension scheme that is likely to have dramatically increased coverage of those at the bottom of the distribution assuming that the programme is well-targeted.
11. The data for Mexico, which are for 2010, do not reflect the reduction in the age of eligibility from 70 to 65 and the recent government announcement that the programme will be made universal. Venezuela introduced a new social pension in 2012 that has dramatically increased coverage.
12. See Knox-Vydmanov and Palacios (2013).
13. See Rofman et al. (2013).
14. Even universal social pension schemes such as Bolivia's do not cover the entire elderly population because of a variety of implementation issues. See Rofman et al. (2013).
15. This is based on two key assumptions – first, that the real value of the benefit will remain constant throughout the projection and, second, that the same ratio of beneficiaries to elderly people will persist.
16. Data were not available for Suriname but it is likely to be among the countries with the highest scores.

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**The following country references apply to the entire publication  
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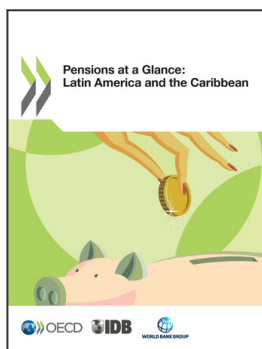
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