Key Considerations for Provision of Social Pension in PNG

Policy Brief

(1st Draft)

June 20, 2013

The World Bank[1]

1. Background and Objectives

The objective of this policy brief is to highlight some of the key considerations and rational for the potential introduction of social pension[2] in PNG. The content of this note draws on the WB mission and discussions with the Government of PNG (GoPNG) that have taken place in mid-May, 2013. The information provided in this note aims to facilitate the dialogue towards potential introduction of the social pension in the country. This policy brief discusses the rational for the program, various policy options and budget costs, and what would be required for the program implementation. *We expect this brief to serve as a starting point in further discussion of the issues surrounding potential social pension implementation at the nationwide level in PNG.*

There currently exists no nationwide social pension scheme in PNG. This is in contrast to other Pacific countries, many of which have had for some time, or have introduced recently, a social pension.[3] The details of the social pension schemes in Pacific Island Countries are provided in *Table 1* below. Interestingly, the closest example of the social pension is one grown domestically -- New Ireland Province has been running its own social pension scheme (SPS) since 2009. The SPS in the New Ireland province can generally be regarded as a success, despite some several implementation challenges. The natural question that emerges then is whether a similar, nationwide scheme is something that would make sense in PNG.

[1] This brief has been prepared by the team led by Alex Ivaschenko, Senior Economist, Social Protection Department, East Asia and Pacific region, email: oivaschenko@worldbank.org.

[2] A social pension is a regular cash transfer to older people. Eligibility is based on age and citizenship/residency, and sometimes on other means such as income, assets or other pension income. Over 80 countries in the world have some form of social pension, although design varies significantly. Note that the brief currently does not include the discussion of the disability pension.

[3] Social pension refers to non-contributory pension. That means that a person does not need to contribute part of its income to become eligible. In other words, attaining a certain age is the only condition for eligibility.

Table 1: Social Pension Schemes in the Pacific Island Countries

Country	Title of the program	Eligibility age	Monthly benefit, LCU	Monthly benefit, current US$	Total annual budget, % of GDP
Fiji	Social Pension Scheme (SPS)	70+	F$ 30	16.4	*0.1*
Kiribati	Elderly Fund Pension (EFP)	67+	AU$ 40 (age 67-69), AU$ 50 (age 70+)	43.3	*0.9*
Samoa	Senior Citizen Benefit Scheme (SCBS)	65+	WST 130	56.0	*1.1*
Tonga	Social Benefit Scheme for Elderly (SBSE)	75+	TOP 65	36.4	*0.2*
Timor Leste	Elderly Pension (EP)	60+	US$ 30	30.0	*2.1*
New Ireland Province (PNG)	Social Pension Scheme (SPS)	60+	K 30	12.8	…

Note: World Bank staff calculations based on various data sources.

The only form of social insurance offered in PNG, the contributory pension plans mandated by the government, have a limited coverage. Similar to other countries in the Pacific, which have contributory pension scheme provided through Provident Funds, PNG also has contributory pensions provided through National Superannuation Fund (NASFUND) and the Nambawan Super Fund (NSF). Both funds offer defined contribution retirement savings plans to affiliated workers. The former one is geared towards private sector employees, and the later one towards public sector employees.[4] However, design and limited administrative capacity limits participation in these plans to people working in firms with 20 or more other employees.[5] NASFUND also introduced a voluntary savings scheme about 5 years ago. However, the number of active contributors to the voluntary scheme, about 20,000 people, constitutes less than 10% of the total active contributors.

The policy environment for consideration of a national social pension appears accommodating. Taking care of the elderly and disabled is a specific Government goal, and has been endorsed in the *Alotau Accord*, a key Government resolution containing 78 priorities for implementation. In considering options for a social pension, the GoPNG has many international, Pacific and local (such as the program in the New Ireland Province) examples to draw from.

[4] NASFUND was established in May 2002, as the successor entity to the National Provident Fund (NPF). It is the largest private sector superannuation fund in PNG Compulsory superannuation contributions in PNG were introduced in 1982. Employees are required to contribute a minimum of 5% of their salary to a superannuation fund and employers of over 20 persons are required to contribute 7%. Employers who were previously registered to make contributions to the NPF are required to maintain their membership with NASFUND.

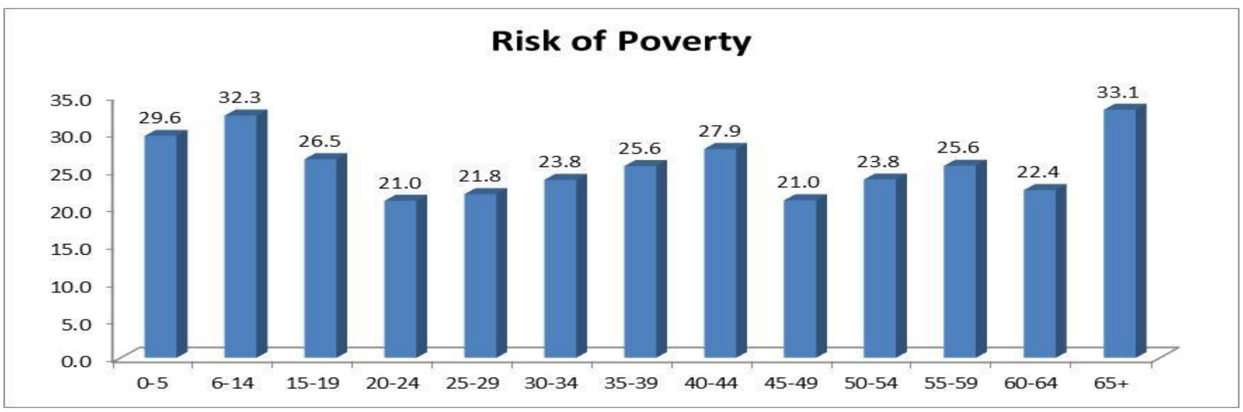
[5] As a reflection of the limited coverage, NASFUND had about 160,000 active contributing members (as of 2012), compared to the labor force of 4 million people.

2. What is a rational for social pension in PNG?

Many countries provide social pensions to their citizens. The main objective of doing it is to reduce vulnerability to the risk of poverty in old age. The benefit level is usually very modest, as the idea is to provide at least minimal level of incomes. This source of income is especially important for elderly people living alone. However, social pensions also perform an important function in families where elderly live with other income earners, as it provides the source of independent income that can support consumption when the family experiences shocks, and can also provide a sense of dignity and feeling of financial "independence" from other family members. It is important to consider that while social pensions are paid to elderly people, this income often trickles down to other family members. What would be the rational for the social pension in PNG?

Despite traditional "wantok" systems of family support, the elderly in PNG face significant risk of poverty. The risk of poverty is especially high for people ages 65 and above.[6] In fact, this age group faces the highest risk of poverty among all population groups. The analysis of the 2010 Household Income and Expenditure Survey (HIES) reveals that 33% of the elderly age 65+ are below the PNG food poverty line (*see Figure 1 below*).[7] In other words, every third person in this age group does not have adequate resources to meet even basic food needs. When it comes to total poverty, which also takes into consideration the costs of the basic non-food needs, the risk of poverty for the elderly age 65+ is 44%.

Figure 1: Risk (incidence) of food poverty by population age group, %



Note: Calculations based on the 2010 HIES data.

The contributory pension schemes have low coverage, and function more as savings schemes rather than pensions with risk pooling. As mentioned before, the contributory schemes available through NASFUND and NSF are geared towards employees of larger private and public sector entities, thus leaving uncovered a substantial portion of the labor force engaged in small enterprises, informal work and subsistence activities. Moreover, NASFUND and NSF do not provide an annuity option for affiliated to draw their pensions upon retirement. Rather, upon reaching an eligibility age (of 55) the participants

[6] Poverty is defined here based on the national poverty line that was derived based on the 2009 Household Income and Expenditure Survey (HIES).

[7] It is important to note that the analysis covers both elderly living alone, as well as elderly living with others. Households with elderly (age 60+) living alone account for only 3% of the total number of households with elderly in PNG. This group of households faces even higher risk of poverty.

can withdraw the balances from their Retirement Saving Accounts (RSA) as a single or several lump sum payments. There are also special provisions which allow contributors to withdraw balances even before reaching the age of 55. This can be done in the events of: (i) job loss (unemployment); (ii) the need to cover medical expenses; and (iii) migration. Because annuities are the principal instrument for ensuring an individual does not outlive their retirement savings, even the covered population in PNG is vulnerable to poverty in old age. As a result of early eligibility age, lump-sum nature of balance withdrawals, and special provisions for withdrawals, many contributory scheme participants find themselves without a secure income in old age.

There is a compulsory retirement age for civil servants. This retirement age is now set at age 60. The compulsory (mandatory) retirement age basically pushes civil servants age 60+ to become economically inactive, unemployed (those seeking other employment), or engaged in alternative economic activities.[8] In many cases, that would mean a drop in the levels of income, even though "retired" civil servants would be eligible to use balances of their retirement saving accounts, as discussed above. In any case, the compulsory retirement age could arguably introduce a potential source of vulnerability in old age, albeit for the segment of the labor force that enjoys the best protections against labor market risks.

3. What would be the key parameters (design) for social pension in PNG?

The design of a social pension in PNG should take into consideration the following key parameters: (i) eligibility age and (ii) benefit size. These two parameters will determine the total fiscal costs of the program, which is an important outcome indicator that would need to be forecasted and monitored by the Government. These parameters/indicators have to be weighted in carefully by the Government. Each of these parameters in turn is elaborated upon below.

(i) Eligibility age

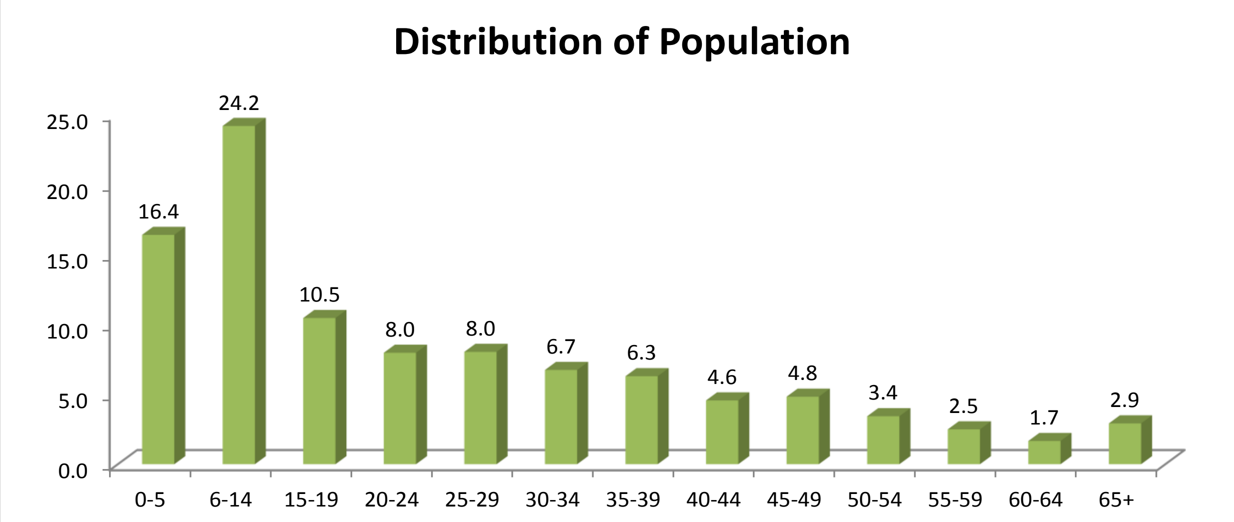
Eligibility age is a very important parameter because it determines how many people will be covered by the social pension. It will also ultimately influence the total fiscal costs. Many factors influence what could be considered as a reasonable eligibility age for social pensions. Those factors include: (i) life expectancy; (iii) labor market (work) incentives; (iii) poverty/vulnerability profile for elderly; and (iv) fiscal space/constraints. Setting eligibility age very high relative to life expectancy will result in many elderly not reaching the eligibility, while setting it very low will result in many beneficiaries and substantial fiscal costs. Similarly, it does not make much sense to provide social pension to people who are still in very productive age, and could take care of themselves through their own work and enterprise.[9] Poverty risk is an important factor because the idea is to providing a social pension to at least the age group facing the highest poverty risk. Finally, availability of public fiscal resources is also often a constraining factor in determining the eligibility age.

[8] In many countries, the provision for mandatory retirement age is expressly unlawful, as it can be considered as a form of discrimination.

[9] Furthermore, life expectancy is something that in almost all countries rises over time with development. In some countries, life expectancy has risen very rapidly, and the eligibility age for social pension benefits has not kept pace. This becomes a fiscal burden. Many countries have started to index or automatically adjust the eligibility age to shift upward with changes in average life expectancy for men and women.

In PNG, the potential social pension eligibility age groups to consider would be age 60+ or 65+. The total age group 60+ accounts for 4.6% of the population, or about 297,000 people.[10] The age group 65+ accounts for 2.9% of the population, or about 190,000 people. The relatively low contribution of the elderly to the total population is a reflection of a very young population in PNG with 51% of the total population under age 20 (see *Figure 2*). The relatively small size of the elderly population in the total population also means that social pensions would cost the Government less than other forms of social assistance targeting larger population groups. But the total cost would depend, of course, on the benefit size, as discussed below.

Figure 2: Distribution of PNG population by age group, %



Note: Calculations based on the 2010 HIES data.

(ii) Benefit size

The size of the benefit (social pension) is important for many reasons. On one hand, the benefit amount should be such that it makes a difference to the livelihoods of beneficiaries. In other words, it should not be too low. On the other hand, the benefit amount should not be too generous, as social pensions are intended to provide some level of income that would not create disincentives to save for retirement (including in the contributory pension plans). This balance between "too low" and "too high" is not always easy to find, as there is no uniform rule for setting the benefit level, since the generosity of the particular benefit should also take into account what other benefits are available, not only at the individual, but also at the household level. However, in many contexts a benefit that is equal to 20-30% of the consumption of the poor households (usually those in the bottom 30% of the per capita consumption distribution) is considered as a good guiding benchmark. In considering the potential size of the benefit, it is also useful to do the analysis that indicates what would be the impact of the benefit on the poverty incidence (risk) of the population group concerned.

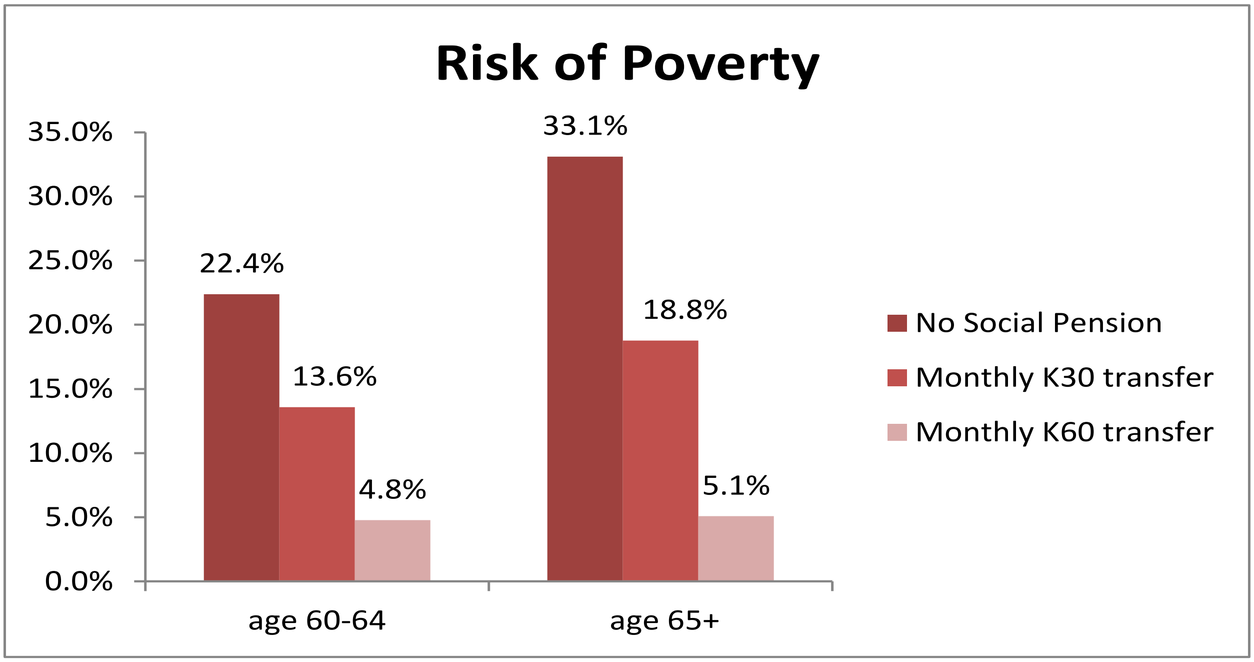
A social pension as low as Kina 30 per month would reduce the risk of poverty for elderly substantially. The analysis of the 2009/10 HIES data shows that a social pension set at K 30 per month would reduce the incidence of poverty from 33.1% to 18.8% for those age 65+, and from 22.4% to 13.6% for those age 60-64.[11] This benefit level is also what New Ireland Province currently pays to beneficiaries of the social pension program, which are people

[10] According to the 2011 National Population and Housing Census.
[11] It is important to note that K30 per month is about 30% of the estimated food poverty line.

age 60+. The benefit of K 60 per month would reduce the risk of poverty from 33.1% to 5.1% for those people age 65+, and from 22.4% to 4.8% for people age 60-64 (see *Figure 3*). This represents a very substantial reduction of poverty.

It is important to provide benefit indexation over time. No matter which benefit level is chosen as a starting point, it is important to ensure that the real value of the benefit is not eroded over time by inflation. It is considered good practice to have an automatic adjustment mechanism, whereby the size of the benefit is adjusted every year depending on the previous year changes in prices of goods and services.

Figure 3: The impact of social pension (K30 vs. K60 per month) on the poverty risk



Note: Calculations based on the 2010 HIES data.

(iii) Annual Budget needed for benefit payments

The required annual budget for benefit payment will depend on the eligibility age and monthly benefit size. In working out the budget numbers we use 2 possible scenarios with respect to the eligibility age (60+ and 65+), and 2 possible scenarios regarding the monthly benefit size (30K and 60K (kina) per month). The results are summarized in *Table 2* below. They suggest that covering the age group of 65+ at 30K per month would cost the budget 68K million, or 0.2% of GDP. The costs would double if 60K per month is paid. Extending eligibility to age 60+ at 30K per month results in the annual bill of 107K million, or 0.3% of GDP. The monthly payment of 60K for this age group would result in the total annual cost of the benefit of 214K million, or 0.6% of GDP. It is important to emphasize that additional funds would need to be assigned to cover the operational costs related to benefit administration. These operational costs would usually not exceed 10-20% of the benefit budget. So, for example, the benefit budget of 107K million per year (as per scenario below), augmented with extra 20%, would result in the total program budget of 128K million.

Table 2: Budget required for benefit payments

Eligibility age	Expected N of beneficiaries	Monthly benefit, Kina	Total annual budget, million Kina	Total annual budget, % of 2012 GDP
60+	296,857	30	107	*0.3*
	296,857	60	214	*0.6*
65+	189,260	30	68	*0.2*
	189,260	60	136	*0.4*

Note: Calculations based on the 2010 HIES and 2011 Census data. The budget provided in the table does include operational costs of the program, which would expect to add 10-20% of the program payment budget.

4. Some of the expected challenges with program (benefit) implementation

Implementation of any new program is bound to face challenges. Those challenges would be related to the following key areas of benefit administration: (i) determination of eligibility; (ii) provision of benefit payments; (iii) maintenance of the up-to-date database of beneficiaries. Those are highlighted below. However, it is worth noting that most of those challenges are not unique to PNG, and have been overcome in other countries at similar levels of development and with similar administrative capacity.

(i) Determination of eligibility

The only condition for social pension eligibility is reaching the required age. That means that, in principle, determination of eligibility should be straightforward, as long as people have national IDs, birth certificates and/or the Office of Civil Registration (OCR) has a reliable database of all people, with birth certificate numbers or other unique identifiers. In practice, though, this is not often the case, particularly in countries with large rural populations, where geography isolates many communities from services, and a large number of births are not recorded. This definitely will be a challenge to overcome in PNG, as many people do not have proper birth date records. In the discussion, the administration of the New Ireland province has clearly identified the lack of birth certificates for many old people as one of the key challenges to implementing a Social Pension Scheme (SPS) there. The program administration has come up with alternative ways of establishing years of birth, including reliance on local community, church leaders, etc. However, this information would still need to be properly recorded. Administration of the SPS nationwide would definitely require significant effort in improving data systems, establishing links between the implementing agency and the OCR, etc. A necessary expertise and technical advice that the Government may need is available in this area.

(ii) Provision of benefit and frequency of payments

People who are identified as eligible for and become enrolled into a program need to be paid. This is often called a transaction stage, and the decisions have to be made about: (i) payment modality; and (ii) payment frequency. The payments can be made in cash (e.g., through post offices) or provided directly into bank accounts (wire transfers). The viability of the latter mechanism would of course depend on how many beneficiaries have access to bank accounts. In practice, a "mixed" approach may need to be used whereby the payment modality would depend on beneficiary personal circumstances (place of living, availability of banking services in the area, etc.).

Mobile banking[12] has been used successfully in many countries. The advantage of electronic payments is that they are associated with lower administration costs and higher security. In many cases, countries started with cash payments (thought post offices, for example) and then later switched to electronic transactions. A recent example of this switch in the Pacific region is Fiji.

The payment frequency is an important consideration. Usually, payments are made on a monthly or quarterly basis. However, when various constraints exist, payment obligations can be accumulated over a certain period, and then paid in a lump sum at the end of the period (e.g., at the end of the year). Although the beneficiary gets the same aggregate amount irrespective of the frequency of payments, the frequency matters for the following reason. The recent evaluation of the SPS in Mexico, for example, has indicated that monthly payments were more likely to be used for food purchases, diet diversification, etc. At the same time, quarterly payments were more likely to be used for purchase of durable goods, helping school age kids with tuition, etc.

How is New Ireland province dealing with payments? In New Ireland province, the current payment modality is cash. LLGs (Local Level Governments)[13] are responsible for the physical delivery of payments (on behalf of the Department of Community Development). The list of beneficiaries is prepared by the Administration Office of the DCD based on the existing database. Upon receipt of the cash transfer the beneficiary signs a respective part of the form.[14] This information is then entered back into the database to establish who received the payments. The benefit is supposed to be paid quarterly. However, because the operational budget is very limited and many recipients are in isolated places (can be reached by boat only), the payment (aggregated amount) is done only once a year. In rolling out the social pension at the national level, it would be important to take into consideration local conditions in terms of access to banking, mobile phone penetration, etc. to come up with the appropriate payment modality. Various modalities of payment delivery could be piloted in selected provinces, to find out what may work best.

(iii) Database of beneficiaries

Creating and maintaining the database of beneficiaries is crucial for the success of the program, particularly to monitor costs and maintain fiscal sustainability. The main function of the database is to keep up-to-date record of all program beneficiaries and trace the payments made. The database forms a core of the Management Information System (MIS). The MIS relies on good information – from ID to transaction – being recorded and transmitted in a timely manner to the government agency/ministry responsible for ensuring that expenditures are reaching their targets. In administering its social pension scheme, New Ireland Province started with a quite basic database in Excel. This has now been transformed into MySQL, which is an open source (free) relational database management system (RDBMS) that runs as a server providing multi-user access to a number of databases. This transition has been done with a support from the New Zealand Consultant. In any case, this expertise is out there, and could be deployed for the creation of the modern MIS.

[12] Mobile banking is a system that allows customers of a financial institution to conduct a number of financial transactions through a mobile device such as a mobile phone or personal digital assistant.

[13] Provinces are divided into districts, and districts are divided into LLGs. For census purposes, the LLG areas are subdivided into wards and those into census units.

[14] In some cases when beneficiary is not physically present, the payment is left with the "ward recorder"/'ward secretary" for subsequent disbursement to beneficiary.

5. Conclusions

This policy brief provides a background for potential introduction of the social pension in PNG. It highlights examples of social pension in other PICs, discusses the rational for social pension in PNG, and presents some of the "usual" challenges that would be expected in implementing the program.

Importantly, the note also presents a preliminary, "back of the envelope" estimate of the fiscal costs of various program scenarios. The analysis suggests that depending on the program coverage (all people age 60+ or 65+) and the monthly benefit size (K30 to K60), the expected annual costs of the payouts would be in the range of K 68 million to K 214 million, or 0.2% to 0.6% of GDP. The Government may decide which fiscal scenario is more appropriate given program objectives and costs.

We expect this brief to serve as a starting point in further discussion of the issues surrounding potential social pension implementation at the nationwide level in PNG.