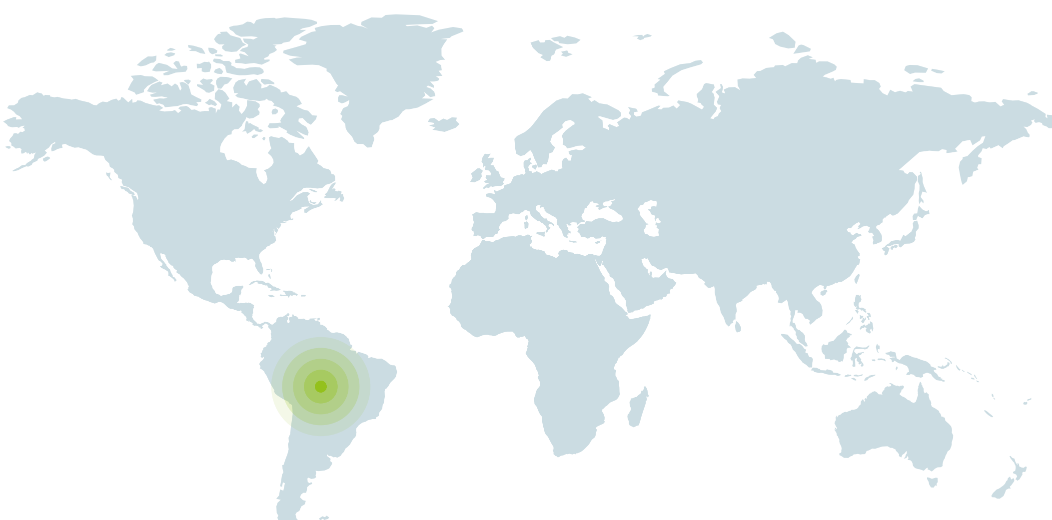
Who is Going to Bear the Cost?

The Rapid Ageing of Latin American Societies as a Socio-Political Issue

Karl-Dieter Hoffmann



Currently, only around 40 per cent of Latin American citizens age 65 and over receive a regular (contributory) pension; a further 20 per cent receive a non-contributory (tax funded) state pension. The remaining elderly must continue to earn a living or rely on support from family members. While the region still has a relatively young population today, the number of people age 65-plus is set to increase to 140 million by 2050, up from under 40 million in 2010. The serious deficits in pension provision are closely linked to the structural characteristics of the national economies, which provide too few formal job opportunities.

Current global population development is characterised above all by a rapidly declining fertility rate in the vast majority of the states officially recognised by the OECD as developing countries. That this trend has had only a minor impact on the global demographic growth rate up to now is due to the fact that the number of women of child-bearing age is at a historically high level and will remain so for some time to come. Latin America is the first region of the so-called Third World where the majority of countries are following the demographic development pattern that the highly developed states of our time followed since the middle of the 19th century while undergoing the process of economic and social modernisation. After a long phase during which falling mortality rates and persistent high birth rates resulted in strong population growth, improvements in working, housing and living conditions (such as access to clean drinking water, better-quality food, reduced risk of infection) provided the right conditions for a gradual reduction in the fertility rate and therefore the birth rate.

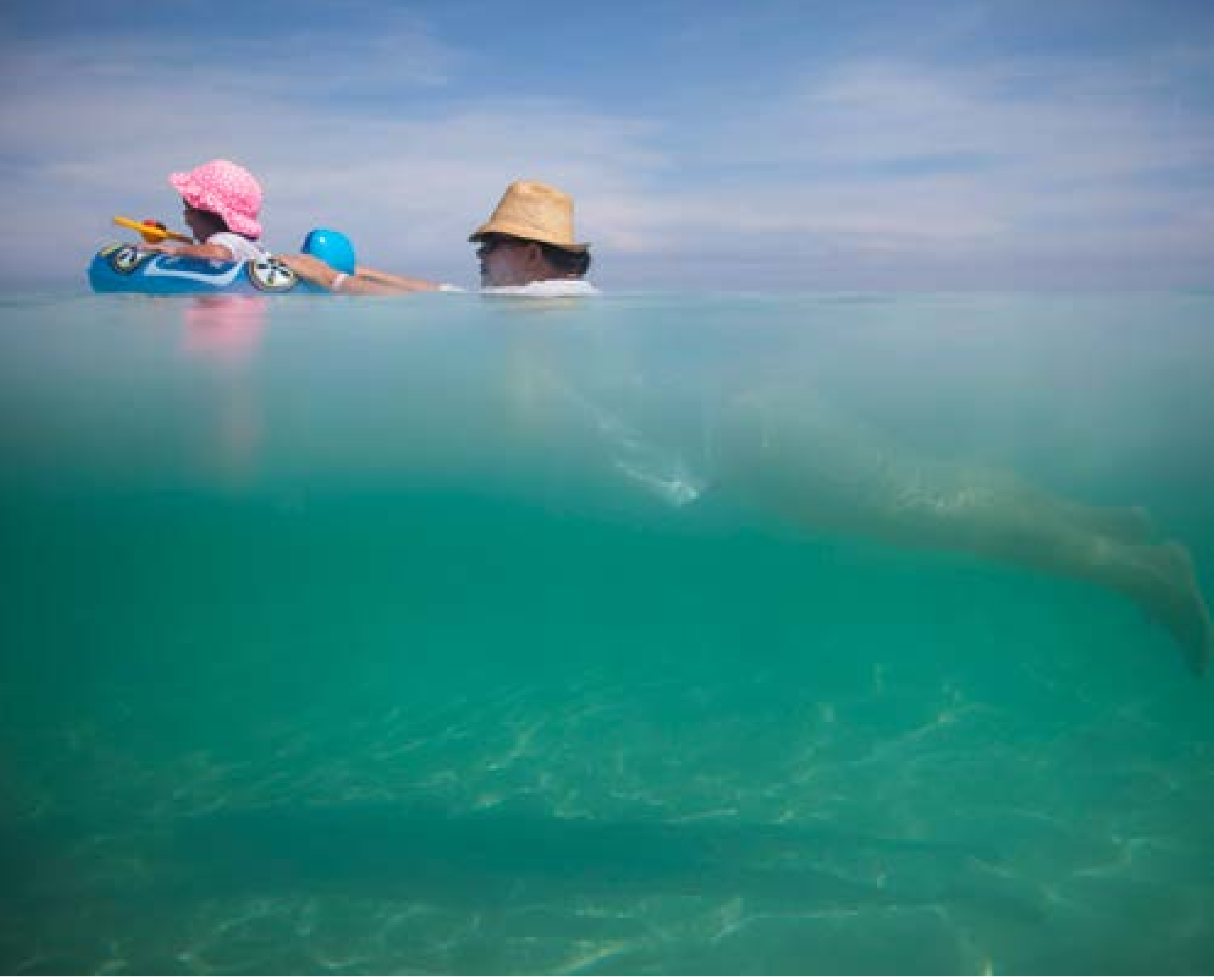
Compared to developments in Europe and North America, this process referred to as "demographic transition" is taking place at a substantially accelerated rate in Latin America. In fact, the rapid demographic change is taking on extreme forms where the age structure is oncerned, manifesting in a steep rise in the relative numbers of men and women of pension age (65 and over) in the population. While it took 115 years in France and 85 years in Sweden for the proportion of elderly people to double from seven to 14 per cent, the same result will be reached within 26 years in Chile, and the period will be even shorter for Brazil and Colombia with 21 and a mere 19 years respectively. Only a small part of this section of the population is entitled to (adequate) payments from a regular pension scheme. This will add within a few decades a serious socio-political challenge to the existing spectrum of urgent social problems in Latin and Central America. As things stand, considerable numbers of elderly people in this region of the world will have little chance of spending the last period of their lives in reasonably carefree social conditions. Public measures and programmes for resolving or at least ameliorating the situation will inevitably place a huge burden on national budgets.

← Gaps in the system: Under the given conditions, a big part of Latin America's older population has few prospects of enjoying carefree twilight years. Source: © Desmond Boylan, Reuters.

Why Latin American Societies Are Ageing so Rapidly

Up to the middle of the 20th century, children and adolescents formed the broad foundation of an age pyramid whose upper layers were considerably narrower, ending in a small peak. At that time, average life expectancy in the region was around 52 years, and every woman bore more than six children on average. By 2012, life expectancy at birth had risen to 74.5 years, while the fertility rate dropped to 2.5 children per woman in the same period. While over half the region's population was under age 20 as recently as 1950, the median age had risen to 28 by 2010. These demographic shifts were due to a strong reduction in mortality rates, itself primarily due to measures controlling infectious diseases as well as gradual improvements in general living conditions. One central key figure in this context is infant mortality, which determines the characteristics of demographic development more than any other indicator. As a regional average, this figure dropped from 128 per 1,000 live births in 1950 to 22 in 2010. This means that only two of every 100 newborns died before their first birthday in the latter year while 60 years previous it was still one in eight.

However positive the impression may be that these average figures convey, one must not forget that there are some glaring differences in a regional comparison, particularly in terms of the demographic realities in the individual countries. In Argentina, for instance, life expectancy stated for 2014 was 76.2 years, while this vital key figure was 71.7 for Guatemala and 68.3



One-Child-Perspective: Whereas the birth rate was 4.3 children per woman between 1975 and 1980 in Brazil, it declined to only 1.9 in the period from 2005 to 2010. Source: © Alexandre Meneghini, Reuters.

for Bolivia. Similar differences exist with respect to infant mortality, which is intimately linked to average life expectancy. In a small group of countries (Uruguay, Argentina, Chile, Panama and Cuba), this key figure has been close to the level of the OECD countries for quite some time. While remarkable progress has been achieved in Bolivia since the turn of the century (60.4/1,000), the number of deaths in the first year of life there (38.6/1,000) was twice the number registered in Brazil (19.2/1,000). Similar differences can be seen with respect to the fertility rates in the individual countries. While women in Bolivia still bore an average 5.8 children in the period from 1975 to 1980, it was just 3.5 in the period from 2005 to 2010. During the same period, the fertility rate dropped from 4.3 to 2.5 in Colombia and from 4.3 to 1.9 in Brazil.

One demographic characteristic that can be observed in all Latin American countries without exception is the marked difference in the life expectancy of men and women. The official average life expectancy in Mexico for 2014 of 76.7 years was based on a value of 79.2 years for women and 74.4 years for men. The discrepancy is even more marked in Argentina, where the (2014) figures were 80.1 and 72.4 respectively. At the same time, women's life expectancy in

Paraguay exceeded men's by a good four years (75.1 compared to 70.9) and in Bolivia by five years (70.9 compared to 65.9). These discrepancies imply that a great many more men than women die before having reached the respective average national age at death. As a result, there were 119 women for every 100 men in the 60-plus range in 2010 on average across the region. This ratio takes on extreme values in Argentina (138/100) and Uruguay (145/100). In Guatemala, the gender ratio among the 65-plus generation is 164 to 100.

In the long term, the combination of falling fertility rates and rising life expectancy will inevitably lead to an increase in the proportion of the population aged 65 and over. In 1975, only some four per cent of the region's population were in this age range, and the proportion of close to seven per cent that was calculated for 2010 (compared to 19 per cent in Europe) may not appear too dramatic at first sight. As is to be expected, this regional average is made up of extremely heterogeneous national figures. In some countries, the relevant proportion was lower than five per cent in 2010 (e.g. Guatemala, Bolivia), while it was close to or over the 10 per cent mark particularly in the socioeconomically advanced countries of the region (Chile, Argentina). Uruguay tops the list with a proportion of 13.9 per cent for 2013. Demographic projections agree on the fact that the ageing process of Latin American societies is set to accelerate enormously in the foreseeable future. Currently, the baby boomers of the 1950s and 1960s are reaching retirement age. In the period from 2000 to 2025, the rise in the proportion of senior citizens (65+) is expected to grow three times faster than the population as a whole. During the following 25 years, this factor is expected to increase to six. By the middle of the 21st century, the demographic weight of the 65-plus age group will amount to some 20 per cent. In populous countries, such percentages translate into huge quantitative dimensions. In Brazil, for instance, the number of people in the 65-plus age range is set to more than triple within four decades – from fewer than 20 million in 2010 to approximately 65 million in 2050. The ratio between this age group and the cohorts of working age, which is referred to as the old-age dependency ratio, is set to increase from eleven to 49 per cent over the course of this period. Parallel to an 18.3 per cent increase in the overall Mexican population from 116 to 137 million expected for the period from 2012 to 2050, official figures forecast an increase in pensioners age 70 and above from 4.8 to 16.6 million, corresponding to a rise of approximately 240 per cent. Calculations for the region as a whole project an increase in the numbers of over-65s from 38 million in 2010 to some 140 million in 2050; over this period, the number of people of working age per person of pension age is set to reduce from 9.6 to 3.2.

The ageing process of Latin American societies will accelerate tremendously in the foreseeable future.

While the progressing reduction in infant mortality was the main cause driving the rise in average life expectancy for a long time, it is now mainly the slow but steady rise in life expectancy among the over-65s themselves that is dictating the upward trend of this key figure. In the period from 2010 to 2015, a 65-year-old woman living in Latin America had an average remaining lifespan of 18.6 years, a length of time that is set to increase by a further 3.4 years by 2050-55. The comparative figures for men of the same age are 16.1 and a further 2.8 years respectively. By the middle of the century, the region's population can expect to have an average life expectancy of 80.3, while the fertility rate is likely to drop as low as 1.8 and therefore below the demographic reproduction rate of 2.1. The number of those over age 80 in relation to the 50-64 age group is set to increase by a factor of three during the first half of the 21st century. By the next turn of the century, average life expectancy is forecast to rise by a further five years; half the population will then be over 47 (median).

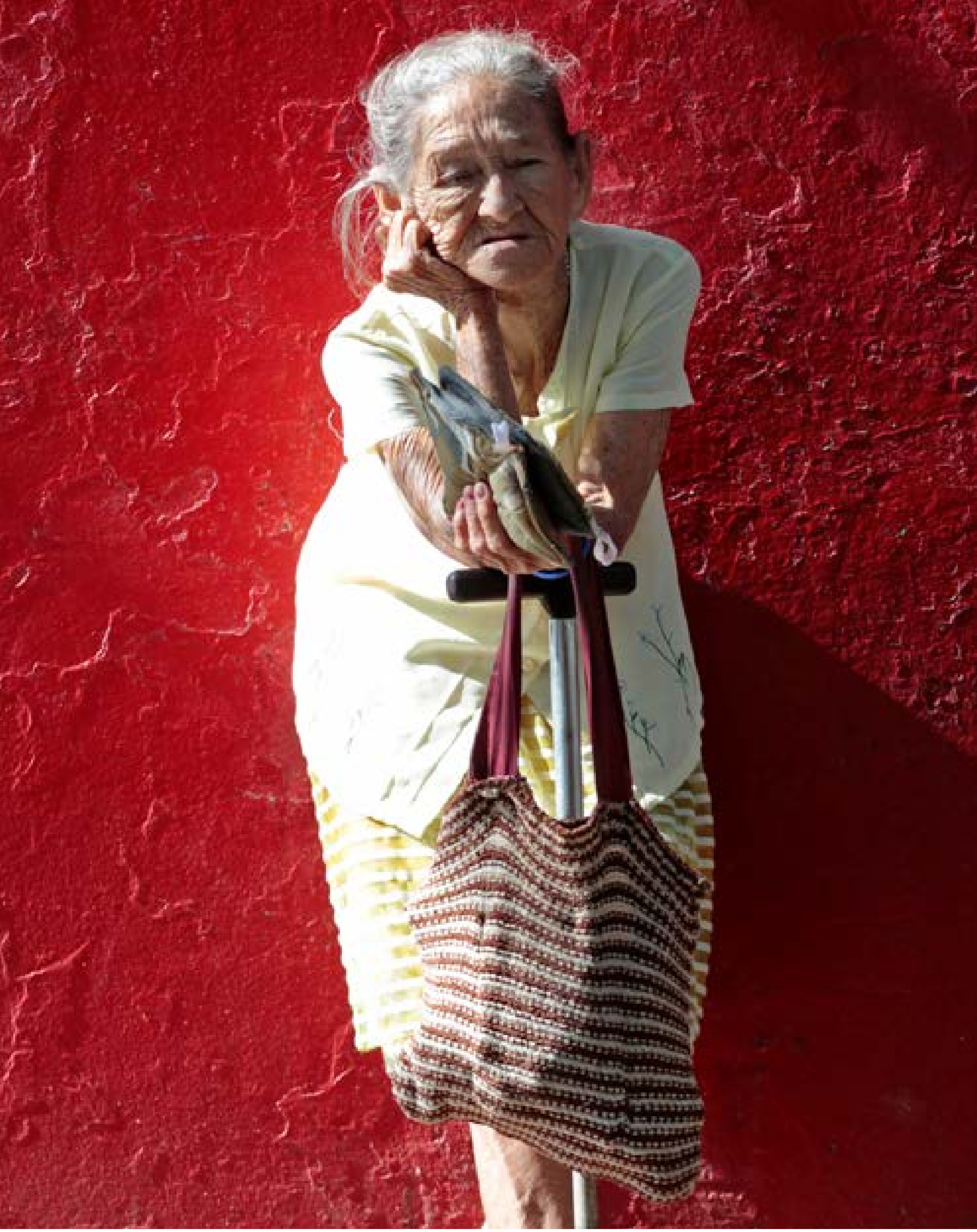
Conventional and Non-Contributory Pension Systems

The speed at which the old-age dependency ratio will increase over the coming decades in large parts of Latin America would cause serious adjustment issues even in countries with a comprehensive and relatively effective institutionalised pension system. The socio-political seriousness of the situation is mainly due to the fact that in a regional average in South and Central America, only 45 out of every 100 people in work are members of a pension scheme or covered by state pension provisions. This low rate of coverage has not been substantially changed by the pension system reforms that have been implemented in several countries (including a general or partial change from pay-as-you-go schemes to capital-forming models) either. A differentiated examination reveals large disparities that are typical for the region as well as serious gender differences. In 2010, there were a total of approximately 130 million people in work who did not make any pension contributions.

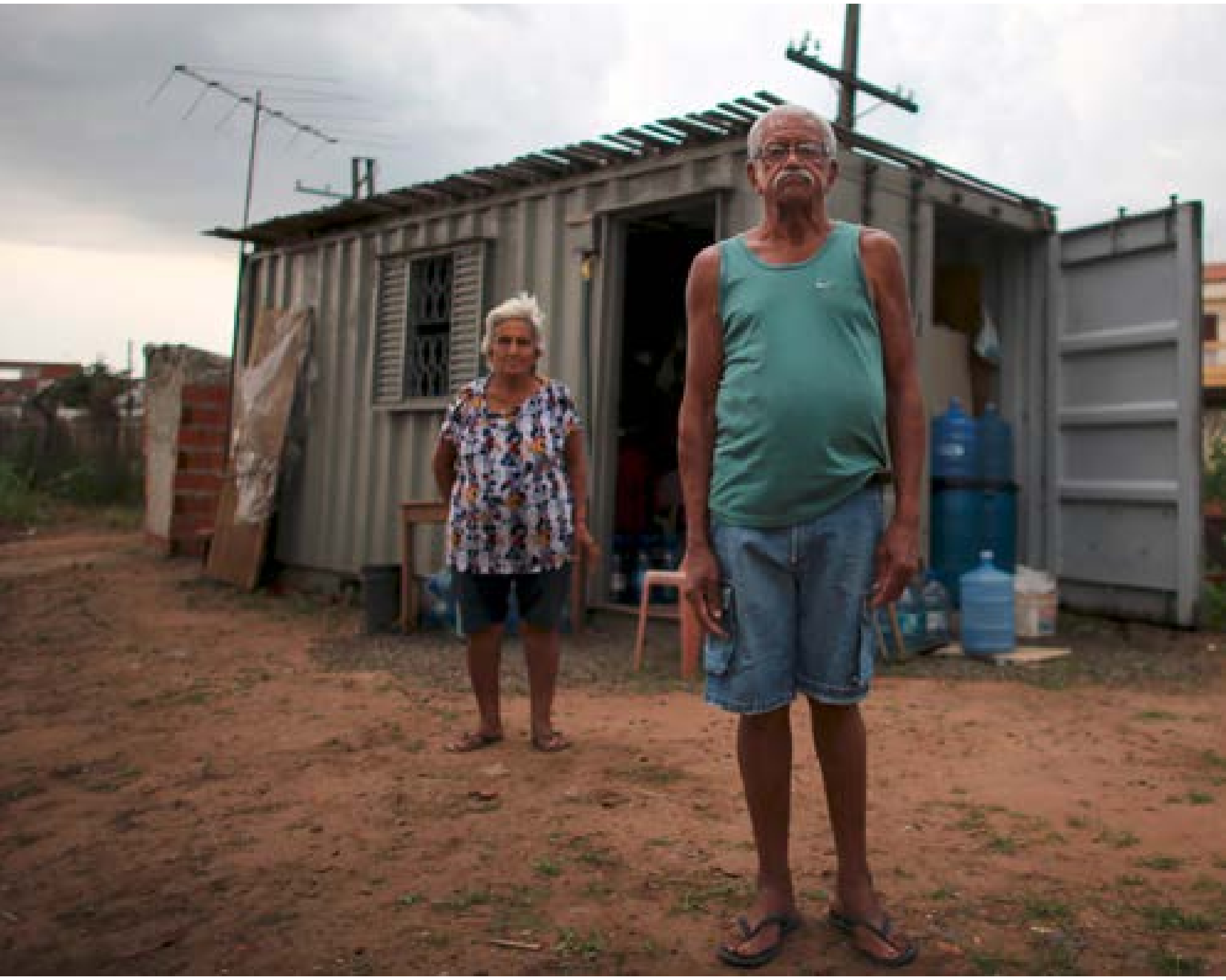
The considerable gap in pension provision is due mainly to the structural makeup of the regional labour markets. The great majority of employees making pension contributions work in the formal commercial sector. And while the state-run pension system has been opened up to people working in the informal economy in all countries, only a small minority of that group (regional average: 16 per cent) are making relevant voluntary contributions. As most people working on a "self-employed" basis only generate a low and frequently fluctuating income, they find themselves incapable of cutting back on present-day consumption to make contributions towards a future pension entitlement. In the formal economic sector, pension contributions are also by no means made by and for all employees. This applies particularly to employees of smaller companies, which can save costs that way and make up for or at least minimise their competitive disadvantage compared to informal businesses.[1] In the formal economic sector it tends to be the low earners who make no contributions to regular pension schemes. The fact that only a small minority of respondents in a survey conducted in Lima and Mexico City among employees not participating in a pension scheme were able to demonstrate a basic understanding of the conditions of the state pension system – over half could not even state the standard pension age – indicates that the majority of low earners had never seriously considered this option of providing for their old age.

Getting to the bottom of the issue is made more difficult by the fact that the number of future pension recipients cannot be reliably extrapolated from the number of current contributors to pension schemes. While many employees have made contributions, they may not achieve the required minimum number of years of contributions and will therefore not be entitled to any payments. Others will only receive very low pensions, which are hardly sufficient to cover their basic needs. Given the extremely unstable labour markets, minimum contribution periods of 15 years and more (e.g. Panama 18, Paraguay and Mexico 25, Ecuador and Argentina 30) have anything but a positive effect on the attractiveness of state-run pension systems. The distinction between the formal and informal sectors or labour markets suggests a dividing line that does not appear to be justified considering that many people swap between the two types of work. A study conducted in Mexico found that 41 per cent of people in work during the period from 2006 to 2010 were engaged at least in one formal and one informal job, while 23 per cent worked only in the formal sector and 31 only in the informal sector. In Colombia, Ecuador and Venezuela, one in four employees working in the formal sector at any one time lost that job within a year. Due to the notoriously insecure job and income prospects, many working people do not bother joining the state pension scheme.

In most countries, politicians have responded to the enormous gap in the numbers of people covered under general pension provisions by creating alternative safety net systems that will



Bleak prospects: Acquiring a state pension entitlement is beyond the means of many low earners; consequently, they often do not even know the retirement age. Source: © Reuters.



Corrugated iron as a retirement home: Only very few Latin American countries are able to pay pensions that come close to meeting the European standard. Source: © Nacho Doce, Reuters.

afford people without a regular pension entitlement a basic level of financial security. The programmes vary greatly in their coverage and in the amount of benefits provided. In Bolivia, the Morales government devised the so-called *Renta Dignidad* (roughly: dignity pension), a model that pays all persons age 60 and over – including those who are entitled to regular pension payments – a state pension. In Mexico, only those age 70 and over who do not receive any other social benefits or moneys from a private pension receive benefits from the *Pensión para Adultos Mayores*. What the two programmes have in common is the modest amount of the monthly payments, which are below the poverty limit of the equivalent of 2.5 US dollars a day; in Argentina, by contrast, the impoverished elderly age 70-plus receive payments equating to seven US dollars a day, while it is 5.50 US dollars in Panama and just under 10 US dollars in Uruguay.[2] In Uruguay, the proportion of tax-funded pension recipients is only eleven per cent because of the low coverage deficit of the regular pension system.

Increasing expenditures for public pension provisions prevent important investments in other sectors.

In Brazil, where the minimum age for receiving non-contributory state pension payments is 65, over a third of this age group receive such benefits (daily rate: eleven US dollars); in Chile and Argentina it is 26 per cent (daily rate: 6.50 US dollars) and 25 per cent respectively with the same age threshold. While similar programmes are of no great significance in Peru, Paraguay and El Salvador because of the low number of recipients, they are entirely non-existent in Haiti, Honduras and Nicaragua.

Using the non-contributory benefit programs for elderly people, several countries have succeeded in significantly reducing the gap in the coverage provided by the conventional pension systems.[3] In addition, measures taken there have improved the general living conditions of many people of pension age reasonably significantly and thereby reduced the poverty risk. At the same time, these types of expenditures place a burden on national budgets, which are under pressure in any case in times of economic weakness. One also needs to bear in mind the low tax rate in Latin America (except Brazil) compared to OECD countries: governments can only spend what they have received in revenues. With the foreseeable rapid rise in the numbers of the over-65s, expenditures for such benefit programmes will inevitably continue to increase. Any government planning to make cuts in existing non-contributory pensions will incur a large political risk because the beneficiaries will represent an increasingly significant part of the electorate. Conversely, political parties and presidential candidates can boost their popularity among voters if they advocate an expansion of the group of recipients of tax-funded pensions and/or an increase in the monthly payments. Generally, the potential election victory wins out over possible subsequent budgetary problems. The rapidly increasing expenditure for the publicly funded pension system ties up scarce state resources that would be urgently required for other investments – in the education sector, for instance, and in the economic infrastructure; this hinders economic progress (that could be achieved through increased productivity and improved national competitiveness). And that in turn limits the capacity of the formal economic sector to create jobs and consequently encourages the continued existence of the large informal sector.

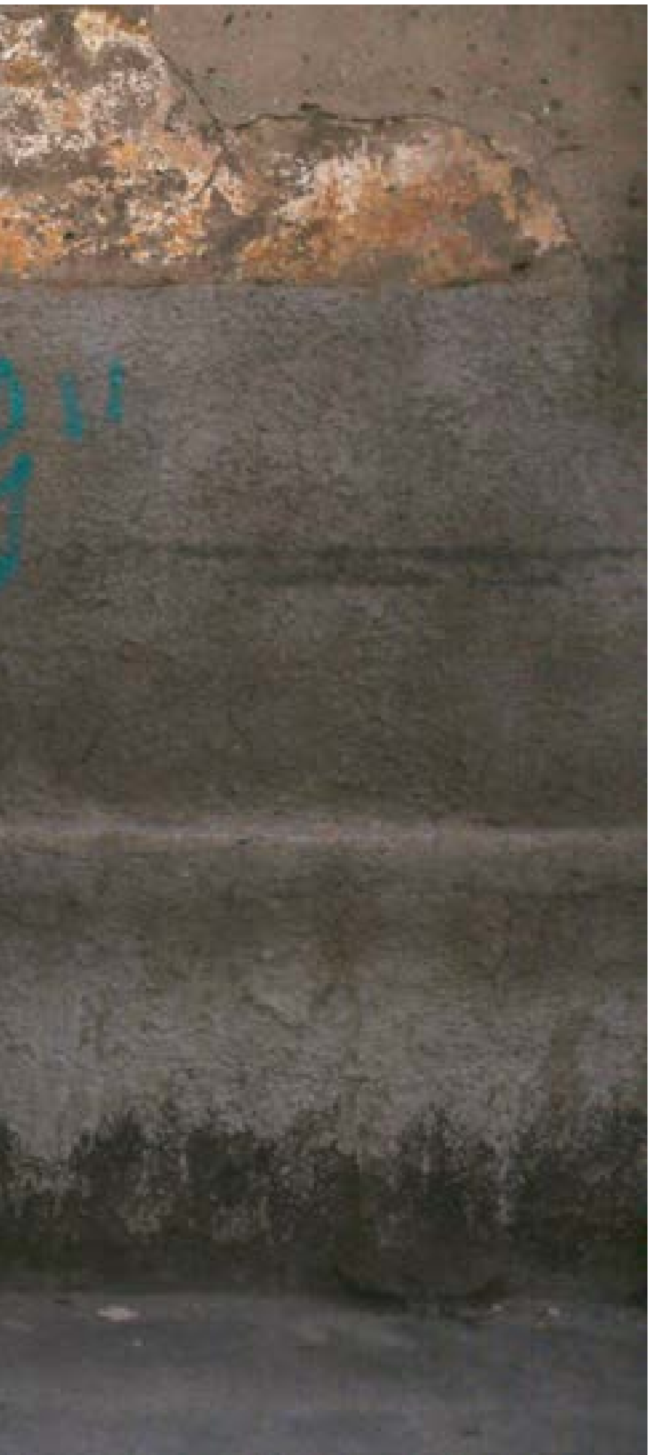
A Pressing Problem without Adequate Approaches for Providing Solutions

Unlike Latin America, Europe and North America not only had a far longer time to adjust to the challenges of a steadily ageing population, the first generation of the industrialised countries also had economic capabilities that made it easier for them to master this task. As things are, only very few countries in Latin America are capable of offering the majority of people in the 65-plus age group social benefits that come anywhere close to the respective standard in Europe.[4] Initiatives to establish institutionalised

care for the elderly have only been established in very few countries (including Costa Rica and Uruguay).

In many countries of the region, contributory and non-contributory pension models together by no means cover all men and women of pension age. On average, this affects over a third of the over-65s in the region, with the proportions being significantly higher in the economically weakest countries in particular. The affected people must rely on support from elsewhere to fulfil their basic needs. While the payments from tax-based pension programmes are mostly rather low, a considerable number of those entitled to a regular old-age pension also receive payments that are not sufficient for them to spend their sunset years in modest dignity. In Ecuador, the proportion of the recipients of both types of pension whose income equates to less than 2.50 US dollars a day is 62 per cent; in Mexico, the equivalent figure is 40 per cent. In many countries, serious shortcomings in the healthcare system further worsen the precarious living conditions of poor elderly people.[5]

Many elderly people without any pension income at all and those whose state pensions or benefits do not cover their needs find themselves forced to continue earning a living. In countries with good pension coverage, fewer than five per cent of those over age 80 are still working, while it is almost 20 per cent in countries such as Peru, Honduras and Nicaragua. In Latin America, the family traditionally plays an important role in supporting its (very) elderly members. Seven out of ten elderly people live in extended families compared to some 30 per cent in Europe. Particularly women – daughters and granddaughters – devote themselves to the time-consuming task of looking after parents or grandparents who are in need of help and/or care in a joint household. This means that hundreds of thousands of women are kept out of the (formal) labour market, incapable of building a pension entitlement of their own – a classic vicious circle. In addition, the funds used for elderly care cannot be used to invest profitably in the future of the younger generation (education, health, housing). Simply due to the



← Wonder Women: It is above all women who care for their frail parents and grandparents and are consequently not available to the labour market. Source: © Pilar Olivares, Reuters.

continuing decline in the fertility rate, there will be less scope for families to compensate for the lack of pension provision. One other, and in many cases additional, variant of financial support is provided by the more or less regular transfers of funds from abroad – particularly from the USA – made by (legally or illegally) employed family members (*remesas*). Particularly in Mexico and Central America, considerably more families would be living below the poverty line without this source of income.

In view of the relatively low tax rate, the obvious remedy for compensating for the financial burden of the non-contributory state pension systems would be to raise tax revenues. Additional payments into the state coffers could be realised by raising tax tariffs and/or stepping up the fight against the notoriously pervasive tax evasion.[6] Disregarding the fact that there are many plausible arguments for increasing state revenues not only, but particularly for those countries in the region whose tax rate is only around half that of the OECD average, such measures would do nothing to address the underlying structural problem discussed above. The same applies to rising tax revenues resulting from greater economic growth rates, which can only be achieved temporarily, as we know from experience and as was clearly demonstrated by the cooling of the economy after the recent regional boom phase (2003 to 2010).

Initiatives and programmes that significantly boost participation in contributory pension schemes and therefore have the potential of limiting the costs of non-contributory pensions are currently no doubt at the top of the agenda. However, making progress in this area is easier said than done. Effecting change in the structure of the regional labour markets to strengthen the formal economic sector is anything but easy and no doubt an extremely long-term undertaking. Corrections will need to be made to the existing provisions of tax legislation that indirectly and unintentionally foster the continued existence of informal economic activities. In Latin America, policy measures in the areas of tax and the labour market therefore frequently influence people's decisions on the usefulness and method of making their own financial provision for their old age.

The non-contributory state pension models turn out to be sociopolitically counterproductive.

Disastrously, particularly the non-contributory state pension models that have been established or massively expanded lately are having some extremely counterproductive socio-political effects. For the vast numbers of low earners who have very little disposable income left after having covered their basic needs, and this affects up to 60 per cent of the working population in the most extreme cases, the tax-funded pension provision represents an alternative to the conventional contributory system. The benefits offered by those programs remove the incentive for uninsured people working in the informal sector to make an effort to seek employment in the formal sector and thereby become part of the state pension system. Following the same logic, these people are also demotivated from making voluntary contributions as most others in the same situation save this expenditure and can still expect to receive a state pension that just about covers their basic needs. One could say that the non-contributory old-age pension provisions (usually linked to healthcare programmes designed along similar lines) constitute a way of subsidising the informal sector. It is therefore obvious that the chances of significantly reducing the numbers of those working in the informal sector rather than the formal sector are very poor.

Consequently, there is a need for innovative concepts that significantly increase the incentives for participation in the contributory state pension schemes. Besides a crucial critical examination and subsequent elimination of all circumstances under government control that raise the attraction of working in the informal sector rather than reducing it, one can envisage programs that top up contributions made to the state pension system by low earners, while guaranteeing a minimum pension that clearly exceeds the monthly payments of the non-contributory state pension provision. While making sense at first sight, combining such an offer with a (publicly announced) gradual reduction in the monthly payments from the non-contributory pension scheme would be more harmful or even counterproductive for socioeconomic reasons (continuing high poverty rates; little chance of moving from the informal to the formal sector for most affected people) as well as political reasons (high proportion of elderly among the electorate)[7], taking all the pros and cons into consideration. However, the hope remains that the fundamental demographic change manifesting in the rapidly increasing proportion of the over-65s and the need for political action this demands will encourage the development of concepts for innovative social programs, the details of which can only be guessed at today. The Latin American governments will probably not take much comfort from the fact that the progressive ageing of society is also increasing political and financial pressures to rethink the design and initiate reforms of conventional pension provisions in Western Europe and elsewhere in the First World with every year – albeit in a different form.

Dr. Karl-Dieter Hoffmann is a Political Scientist at the Central Institute for Latin American Studies at the Catholic University Eichstätt-Ingolstadt.

1 "On average, barely 20 % of workers in firms with fewer than five employees contribute to social security. For large firms (with more than 50 employees), that contribution figure is 70 %." Bosch, Mariano/Melguizo, Ángel/Pagés, Carmen 2013: Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean, Washington D.C., p. 48.

2 The stated dollar amounts are not based on the official exchange rate, but reflect the real purchasing power of the state benefits in the respective country (converted to US dollars for comparison purposes) according to the principle of purchasing power parity (PPP).

3 In Argentina, Brazil and Bolivia, the proportion of pension recipients among the 65-plus generation has now reached the OECD level. While only some five per cent of rural workers have paid pension contributions in Brazil in the past, today around 90 per cent of the elderly living in rural areas receive payments from a non-contributory benefit program.

4 The international NGO Help Age International regularly assesses the living conditions of older people around the world on the basis of a differentiated catalogue of criteria. According to the Global Age Watch Index 2015, Panama, Chile and Uruguay are the Latin American countries where the elderly are comparatively well provided for, while Venezuela, Honduras and Paraguay offer the worst general conditions for old age. Cf. HelpAge International 2015: Global AgeWatch Index 2015, London.

5 In combination with other risk factors (such as increasing levels of obesity, indicators pointing to an increase in the number of smokers), inadequate medical care for older people with health problems could result in demographic forecasts indicating a continued increase in average life expectancy having to be revised sooner or later.

6 In Brazil, some financial scope could be created by reducing the expenditure for the pensions of former state employees, which are still extremely generous despite some initial reforming measures during President Lula da Silva's term in office. But enforcing this politically would meet with massive resistance. The pension provisions for some three million former state employees cost a multiple of the expenditure for the conditional cash transfer program *Bolsa Familia*, which benefits over 50 million people.

7 "In 2010, the 65-and-over population accounted for approximately 10 % of the electorate. In 2050, this population segment will represent 23 % and in some countries like Chile, the segment will make up 27 % of the electorate. Moreover, the fact that elderly adults are more likely to vote than younger people means that the effective percentage of the electorate made up by the elderly could reach 30 %." Bosch/Melguizo/Pagés, n. 1. pp. 32 f.

Literature used and further reading

Bosch, Mariano / Melguizo, Ángel / Pagés, Carmen 2013: Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean, Washington D.C., pp. 32-33.

Hoffmann, Karl-Dieter 2010: Steuern, Subventionen und soziale Ungleichheit in Lateinamerika, in: GIGA Focus Lateinamerika 7/2010.

Hoffmann, Karl-Dieter 2012: Poverty, Social Inequality and Conditional Cash Transfer Programs in Latin America, KAS International Reports 5/2012, pp. 90–118, in: http://kas.de/wf/en/33.31046 [30 Nov 2016].

Hoffmann, Karl-Dieter 2015: Pobreza y desigualdad: la necesidad de un enfoque multidimensional, in: Nueva Sociedad 258/2015, Buenos Aires, pp. 77-84.

Huenchuan, Sandra (eds.) 2016: Envejecimiento e institucionalidad pública en América Latina y el Caribe: concepto, metodologías y casos prácticos, Santiago de Chile.

Organisation for and Economic Cooperation and Development / The World Bank / Inter-American Development Bank 2015: Panorama de las Pensiones: América Latina y el Caribe, Washington D.C.

Population Reference Bureau 2014: Life Expectancy Gains and Public Programs for the Elderly in Latin America and the Caribbean, Washington D.C.
Rofman, Rafael / Apella, Ignacio / Vezza, Evelyn (eds.) 2013: Más allá de las pensiones contributivas. Catorce experiencias en América Latina, Buenos Aires.

Rossel, Cecila / Filgueira, Fernando 2015: Vejez, in: Simone, Cecchini / Filgueira, Fernando / Martínez, Rodrigo / Rossel, Cecilia (eds.): Instrumentos de protección social: caminos latinoamericanos hacia la universalización, Santiago de Chile, pp. 225–259.

The World Bank 2011: Becoming Old in an Older Brazil. Implications of Population Aging on Growth, Poverty, Public Finance and Service Delivery, Washington D.C.