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TITLE:

THE FISCAL IMPLICATIONS OF INTRODUCING A NON-CONTRIBUTORY SOCIAL  
PENSION SYSTEM IN KENYA

BWIRE LILIAN ADONGO 065640

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Strathmore University

Strathmore Institute of Mathematical Sciences

Strathmore University

Nairobi, Kenya

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I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the Research Proposal contains no material previously published or written by another person except where due reference is made in the Research Proposal itself.

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..... Bwire Lihan Adongo ..... [Name of Candidate]  
..... [Signature] ..... [Signature]  
..... 30/NOVEMBER/2017 ..... [Date]

This Research Proposal has been submitted for examination with my approval as the Supervisor.

..... JOHN O. OTHUKA ..... [Name of Supervisor]  
..... [Signature] ..... [Signature]  
..... 30/11/2017 ..... [Date]

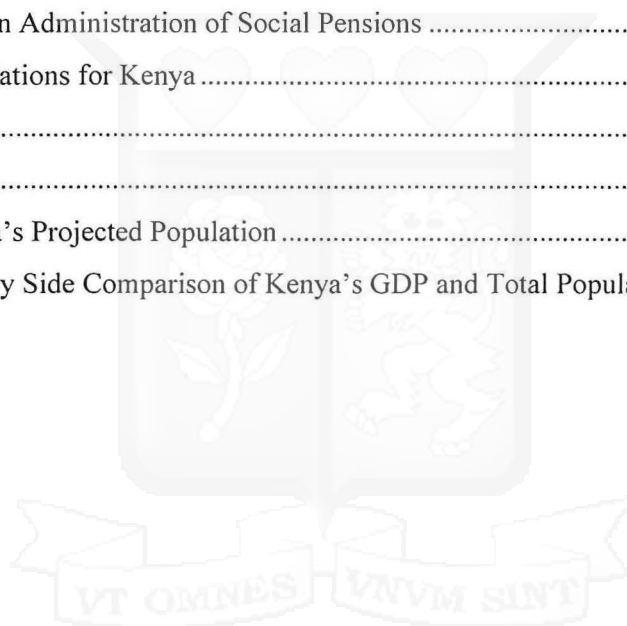
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## LIST OF ABBREVIATIONS

NSSF – National Social Security Fund

RBA – Retirement Benefits Authority

WB – World Bank

ILO – International Labor Organization

UNDP - United Nations Development Plan

GDP – Gross Domestic Product

SSA – Sub Saharan Africa

KNBS - Kenya National Bureau of Statistics

KPHC - Kenya Population and Housing Census



## Abstract

Many countries in Sub Sahara Africa are facing an imminent long term problem: inability to provide old age security to their citizens. The danger is almost certain for many of these countries as they all present the tale-tell signs; presence of a large informal sector that is not adequately covered by a default social security system, high rates of unemployment, rapidly growing aging population and inefficient social security systems. These are all red flags and unless countries in Sub Sahara Africa make rapid and sustainable reforms in their pension systems, they are all likely to face chronic poverty among the elderly. As it stands, pension coverage is already very low, access to health care and other essential services is difficult and many households are headed by an elderly person. This only serves to increase vulnerability among the elderly as they are more likely to become impoverished. After decades of pursuing a contribution based system, coverage and adequacy still remains low and insufficient. This is why researchers are advocating for a more direct approach that will cater for all the elderly, with or without a previous history of contribution. Many countries are now trying to explore the possibility of introducing direct cash transfers to the elderly, also known as universal social pensions. This paper looks at the benefits of introducing a non-contributory social pension system in Kenya and particularly focusses on the fiscal resources required to fund the program and sustain it for long term use. The data collected from previous research conducted in other developing countries that have introduced this universal social pension provided great insight on the problems that are likely to arise and the difficulties faced by policy makers in trying to implement such a program. This report's main findings are really just a discussion of how much the Kenyan government will be forced to allocate, in terms of fiscal resources, to the program and at what cost (fiscal trade-off). It also provides some suggestions for the Kenyan government in case the program were to be fully implemented. As of 2017, a pilot cash transfer program was already underway.

Keywords: Sub Saharan Africa, social pensions, cash transfers, aging population, pension system, developing countries, universal social pension.

## CHAPTER 1

### 1 INTRODUCTION

#### 1.1 Background of the Study

A pension plan can be defined simply as a way that employed persons transfer part of their current income to retirement income. More formally, pension plans are especially designed to provide a means of income to persons who can no longer earn an income because of advanced age, disability or death of the bread winner. Different countries may employ different ways of administering their pension systems, however, the baseline is creating good social welfare conditions for its aging citizens. Pension plans essentially insure individuals (and their families) against a future loss in earnings.

In most developed countries, pension systems have been in existence for decades. Modern pension funds may have been introduced after World War II, however, research on pensions and social welfare dates back to 1889. The oldest known English Economics journal, “The Quarterly Journal of Economics,” published a memoranda on the German Act on pension insurance for workmen. Further articles on labor pensions, old age pensions and insurance were published in the late 1890s. Frederick L. Hoffman, a statistician in the early 1900s deliberated the idea of pension systems, specifically those addressing the aged poor. An Act of Parliament of the United Kingdom, the Old Age Pensions Act of 1908 is regarded as one of the oldest forms of social welfare.

Pension funds and retirement savings are becoming issues of central concern to policy makers all over the world today. As more and more people approach the retirement age, an eminent shift in demographics is expected with the aging population outnumbering the working population. Countries and governments must therefore prepare for the economic and even fiscal implications of this change by ensuring that social security systems are sound and effective. Globally, old persons, women and children are regarded as a vulnerable group and governments are expected to support and care for such groups, particularly the aged.

As baby boomers begin to steadily fill the ranks of the retired population, certain factors such as retirement behavior, retirement savings, program participation costs and the like, are of great importance to researchers, statisticians and policy makers in regards to providing sustainable retirement income. It is for this very reason that pension reforms are now a widespread concern especially in developing countries.

Some countries such as Chile have had a complete overhaul of their former social security systems in favor of systems that have been shown to be more effective. The Chilean model of 1981, as it has come to be known, is one such system. The problems that arise due to great changes in demographics are unfortunately not limited to developing countries.

A United Nations Population Division report on developed countries — particularly those of Europe — reports that these countries will need a massive influx of immigrants to offset the effects of population decline and ageing. (United Nations, 2000). French demographer, Hervé Le Bras raised further concerns such as the level of productivity in coming years and the viability of current pension plans when longevity is increased. (Le Bras, 2000).

## 1.2 Motivation for the Study

Why are pension systems needed?

In many traditional societies, close relatives or even the community took care of the elderly in their society. Women and children too were taken care of upon the demise of the family's bread winner. Social pressures from urbanization, migration from ancestral lands in search of better opportunities and declining family size has led to changes in family structures, roles and erosion of family ties. This makes it harder for the elderly to rely on family support. They are left with no safety net and as their economic power dwindles, old age poverty sets in. Inability of the government to fulfil her expected role in the support of the aged citizens further aggravates the situation. (Reynaund M., 2000)

Social security may certainly not appear to be the most pressing issue for many nations today. However, if this problem is not addressed today, future generations may be left with too great a

burden to bear. It is a critical policy priority much like health care, education and development. The United Nations estimates that in 35 years, the population of people aged 60 years and above will be around 2 billion. Of these 2 billion senior citizens, 80% will be living in the developing countries. On the African continent, persons over 60 years represent the fastest growing population. A report by Help Age International estimates that by 2050, the number of people over 60 years will increase nearly fivefold. These statistics are worrying seeing that African nations lag behind when it comes to social security policies.

Presently, one in every five among people living on less than a dollar a day are over 60 years. So Africa and more specifically, Kenya cannot ignore issues surrounding the aging population. They need to be addressed early enough to avoid catastrophic economic consequences in the future. Introducing sustainable and functional social protection systems in Kenya and even Africa at large will provide much needed support for numerous households headed by elderly persons, alleviate old age poverty and in a way, improve demographic pressures.

### 1.3 Problem Statement

It is clear that there is a vital need for the introduction of sound social welfare systems in many nations across the world, particularly in Africa. Many African nations have welfare systems, only these systems are underfunded, poorly managed and with very low coverage of less than 10% of the population. There is need to replace income after active working years and this is the basis for setting up social security systems. This makes the social welfare sector ripe for more reforms that will improve efficiency and secure the financial future of the aging population.

Social security are benefits that the society provides to individuals or households through collective public measures to promote better living standards (Ginneken, 1998). Ginneken (1998) further explains that pension benefits are only paid to an individual or his family on the basis of that person's employment record and prior contributions to the system. Social security is therefore a form of social insurance and in Kenya, we have the NSSF.

Kenya, being a British colony, has adopted a much similar social security system from the British. Our NSSF is similar to the British state pension, for example. Furthermore, we are now setting up occupational pension funds just like the UK (Mghali C., 2013). This is because an increasing number of the Kenyan population task force is now being employed in the private sector.

Like many African countries, Kenya has in recent years undertaken major reforms to its pension system over the last decade. In 1997, a new Retirement Benefits Act was enacted and three years later, a comprehensive network of regulations was implemented. A major driver for these reforms is to strengthen the country's existing pension system. The Retirement Benefits Authority (RBA), which is the regulatory authority, regulates and supervises the retirement benefits sector. This paper will focus on the National Social Security Fund (NSSF), which is the mandatory scheme for most formal sector employees and look at the strides made in the last two decades and the challenges that the fund still faces.

This research paper aims to identify weaknesses in the existing system that policy makers and stakeholders may consider in their continued efforts for further reforms of the system and to also look at the fiscal implications of these suggested reforms.

It has been almost two decades into the sector's reform initiatives and a lot still needs to be done. While there have been a few improvements here and there, the NSSF still faces the challenge of increasing coverage and also increasing benefits adequacy. Notable achievements of the last two decades after reforms in the system were initiated are the inclusion of informal sector workers and the creation of voluntary employer sponsored occupational schemes. However, three key problems still face the pension system in Kenya;

- (i) There is low coverage particularly in the rural areas
- (ii) Post-retirement poverty levels are high
- (iii) Retirement savings levels are low

#### 1.4 Research Objectives

The paper's research objectives are:

- (i) To find out the feasibility of a non-contributory scheme that aims to pay an amount X to senior citizens (60 years and older) over a period of 25 years.
- (ii) To find out the fiscal implications of such a pension scheme
- (iii) To find out how such a system will be funded.

#### 1.5 General Research Question

Are the current fiscal conditions favorable for an introduction of mandatory social old age pension in Kenya?

#### 1.6 Specific Research Questions

- i. Is it feasible to introduce a non-contributory social pension that pays an amount X to all persons who attain a specific retirement age?
- ii. What will be the fiscal and social implications of such a scheme?
- iii. How much workforce contribution and government contribution is needed to make such a social program sustainable?

#### 1.7 Scope of Study

This paper will focus on the pension system in Kenya and the possibility of introducing a redistributive program that will enable Kenya have both contributory and non-contributory pension systems. It will cover various aspects of social pension systems such as their evolution, history and role in societies, the merits of social pensions and their introduction and expansion in countries that already have contributory schemes, albeit dysfunction. While at it, the paper shall also weigh the feasibility of a non-contributory pension scheme in Kenya taking into account fiscal costs, administrative capacity to implement such a scheme and the potential

negative incentives that will arise due to its introduction. This paper essentially looks into social pensions as a public policy solution to old age poverty and low coverage.

## 1.8 Justification of Study

The nature and coverage of Kenya's contributory pension scheme leaves a lot of room for improvement. The state of the country's social assistance for aging citizens is severely inadequate, leaving a huge percentage of senior citizens wallowing in poverty right after retirement. This is the case for contributing members of the scheme. The situation is worse for non-contributing senior citizens because the scheme only caters for the former and is tied to their contribution history.

There has been an intensifying debate over pension reforms as more countries look for the ultimate solution for low coverage and inadequacy of their contributory pension systems. While pensions linked to contribution histories are more widely used, more policy makers are looking into the non-contributory kind, in the spirit of improving social welfare for aging populations. The reliance on contributory schemes, especially in developing countries, is now being seriously questioned as coverage remains chronically low even after reforms have been implemented. The situation is not any better even in middle income countries as coverage rarely ever exceeds 50% of the workforce.

The time is ripe for Kenya to introduce a social pension scheme for aging population with little or no history of contributions. Some developed countries such as Australia supplement their main schemes with a safety net targeted at the poorest elderly. (Palacios R. & Sluchynsky O., 2006) A social pension scheme has the potential to bridge the coverage gap which is widest in developing countries like Kenya.

## CHAPTER 2

### 2 LITERATURE REVIEW

#### 2.1 Theoretical Framework

The development of pension systems is very important to the African region because pension funds play a critical role in supporting long term investment through savings. Many African countries have undergone major reforms in their pension systems such as Nigeria whose pension industry grew from US\$7 billion in 2008 to US\$25 billion in 2013.

Pension funds in Africa not only play a critical role in finance but are also capable of providing a strong social protection system to help alleviate poverty in old age and improve demographic pressures that the continent will face as the aging population continues to grow.

According to the International Labor Organization (ILO), only one in five workers is covered by a basic social security scheme. This ratio does not even factor in the unemployed, meaning that pension coverage, particularly in Sub-Saharan Africa is critically low. The World Bank points out that globally, 85% of people aged 65 years and older have no retirement benefit at all. (Holtzman H., 2001). Palacios, Pallares-Miralles (2000) assert that less than 10% of the aging population in Sub-Sahara Africa has a contributory pension.

Barrientos and Lloyd-Sherlock (2002) findings indicate that there is a huge debate on how best to create and fund old age pensions in many developing countries. Key policy makers are looking into ways to best cushion the continent's aging population against poverty after retirement. Furthermore, it is important that policy makers look into ways of including non-contributing citizens in the benefits plan.

Developing countries generally lag behind when it comes to establishment and governance of social institutions such as pensions. Since they lack adequate resources needed to cater for formal pension systems to their senior citizens, non-contributory pension programmes will play a key role in the alleviation of old age poverty and sustenance of the aging population. (World Bank 1994, 1997, 2003). In addition to this, Ardington and Lund (1995) assert that

non-contributory pension systems facilitate social and economic development. Non-contributory pension schemes and other such programmes, unfortunately, are offered in very few developing countries such as South Africa and Brazil. (Ferreira, 2004; Willmore, 2001)

## 2.2 Current Pension System in Kenya and the Proposed Amendments

The National Social Security Fund is the mandatory scheme for all formal sector employees. It was established in 1956 under an Act of Parliament. Initially, it was a provident fund but after reforms in 1997, the NSSF was defined as a retirement benefits scheme and as such, came under the regulation of the Retirement Benefits Authority.

As earlier stated, the NSSF largely covers formal sector employees. It however, excludes government employees who are covered by the public service pension scheme. In a bid to increase coverage, the NSSF introduced voluntary contributions in 2006 with the aim of attracting people working in the informal sector. Whether this campaign was successful or not, is hard to tell due to unavailability of data.

Employers with more than five employees are mandated to contribute to the scheme. By law, contributions are set at 10% of net pay with a maximum contribution of KES 400 per month. 5% of the statutory contribution is paid by the employee and the other half by the employer. The Act provides for alternative contributions to another approved scheme at the discretion of the employee. The proposed reforms suggest an increase in the monetary ceiling from KES 400 as this figure is deemed inadequate and not adjusted for inflation.

At retirement, the NSSF pays a lump sum amount of the benefits. The Act allocates a minimum of 2.5% interest rate per year to be credited to member accounts. In 2004, modest grants for funeral and maternity were introduced. Proposed reforms suggest that members receive a percentage of their benefits as a lump sum amount and the rest is invested in an insurance and thereafter paid as annuities.

Governance of the NSSF is done by a Board of Trustees. They are appointed by the Principal Secretary of the respective ministry tasked with matters concerning labor and social security. Members of the board are comprised of representatives of the government, employers and employees. The scheme's investments are handled by an investment department with no external custodian of the assets.

### 2.3 The Role of Social Pensions

Social old age programs existed as early as the late 19<sup>th</sup> century. Denmark, for instance, had a cash transfer program that specifically targeted needy citizens over the age of 60. It was locally administered and its coverage was nearly one fourth of the elderly population receiving around 20% of income per capita. (Palacios R. & Sluchynsky O. 2006) Financing of this welfare program was split between local and central governments of the country.

In the early 1900s, other countries such as Australia, New Zealand and Sweden adopted a similar program with some degree of variations. German leader, Otto von Bismarck, would later introduce a new type of pension which would pay workers when they attained the age of 65. The Bismarckian, as it was later named, was funded by a tax imposed on the tobacco industry. Essentially, this was a social pension scheme. It was however turned into a contributory pension scheme when workers' benefits were tied to their contribution histories in a bid to make them help finance the scheme. This system would later spread across Europe and was adopted across the globe.

Today, such pension schemes are the dominant element of retirement income security policies across the world. Reliance of old age income security is mostly on contributory pension schemes because very few countries rely primarily on non-contributing schemes.

The eligibility criteria of a social pension is therefore not tied down to a history of contributions made either by the individual or their employer. They could simply be described as cash handouts or cash transfers and not savings.

Social pensions are presented differently in different countries. Simply put, in countries where contributory pension systems exist and have a good coverage, social pensions could be used as safety nets for the country's poorest senior citizens. This is mostly seen as the case in developed countries. Countries such as New Zealand that do not have a mandatory contributory pension scheme employ non-contributory schemes which pay benefits to most or all of the senior citizens above a certain age. In these countries, social pension schemes are the core old age welfare program. Another set of countries uses social pension scheme alongside the contributory scheme, for instance, Australia.

The question that arises for developing countries is whether to use social pension schemes as a primary old age welfare program or as a supplement to the contributory pension scheme and mainly focus on uplifting the elderly poor?

Kakwani and Subbarao (2005) state that African households that have elderly members are more likely to be poor in 9 out of 15 countries. Furthermore, they assert that households led by an elderly grandparent, as is the case with "skipped generation" households, are even more likely to be poorer.

In the case of Kenya, it would be imprudent to do away with the contributory pension scheme and introduce a social pension as the core element of old age welfare program. A better suggestion would be the incorporation of a non-contributory scheme alongside the country's NSSF. Because, despite operating for decades, coverage rates of the NSSF are still low and most of the workers that participate in the contributions are a small percentage of those in the upper half of the income distribution.

It is a sad reality and it can be seen all across the world in developing countries as well as some middle income countries. The World Bank, United Nations Development Plan (UNDP), the International Labor Organization and major advocacy groups are now turning their attention to non-contributory pension schemes in a bid to increase coverage rates and bring down old age poverty.

Studies that analyzed countries such as South Africa and Brazil on the impact of social pension programs report positive findings in terms of overall economic growth of the countries and poverty alleviation.

## 2.4 Effects of Social Pension Schemes

Social pension programs are known to have a variety of effects, both directly and indirectly on major aspects of a country's economy. Palacios and Pallares- Miralles (2000) It may touch on macroeconomic issues such as labour supply, fiscal trade-offs and budgeting, savings and economic growth.

### 2.4.1 Fiscal Trade-off

This is one of the most obvious implications and it looks at how much expenditure the government will set aside to cater for the social program's funding. How will the government raise this amount of money? Fiscal trade-off, simply put is, how much of allotted expenditure of department X will be given up in order for the social pension to be funded. Here we assume that the national budget remains the same.

In the case where the budget will be increased in order to fund the social pension program, then the government needs to look at other funding sources such increasing taxes and levies or borrowing from financial institutions. This first scenario means that funding of the scheme lies mainly with the working citizens, including those contributing to the NSSF. The second case implies increasing the national debt.

Fiscal trade-offs are better measured when the cost of funding the social pension program is expressed as a percentage of government expenditure as shown in Table 1 below. In a sample of just 9 countries, the table shows that a large social pension program will come at a significant cost to other budgeted programs or additional debt. (Palacios R. & Sluchynsky O., 2006)

Table 1: Estimated cost of universal pension for selected countries, 2004-2005

(Eligibility Age)	Elderly / Population		SP Spending / GDP		SP / Total Gov Spending		Assumptions	
	60+	65+	60+	65+	60+	65+	Gov spending / GDP	Year of data
Egypt, Arab Rep.	7.0%	4.7%	1.1%	0.7%	3.9%	2.6%	27%	2003/04
El Salvador	6.4%	5.3%	1.0%	0.8%	5.2%	4.3%	19%	2003
Kenya	3.7%	2.8%	0.6%	0.4%	2.6%	2.0%	22%	2004
Kyrgyz Rep.	7.8%	6.1%	1.2%	0.9%	5.8%	4.6%	20%	2005
Pakistan	5.3%	3.8%	0.8%	0.6%	4.9%	3.5%	16%	2005
Senegal	4.1%	3.1%	0.6%	0.5%	2.7%	2.0%	23%	2003
Thailand	8.9%	6.9%	1.3%	1.0%	7.7%	5.9%	17%	2004
Tunisia	7.5%	6.2%	1.1%	0.9%	4.2%	3.4%	27%	2003
Venezuela	7.2%	4.9%	1.1%	0.7%	4.6%	3.2%	23%	2001
Vietnam	6.9%	5.5%	1.0%	0.8%	3.9%	3.1%	27%	2002

Source: IMF Data on Government Expenditures

#### 2.4.2 Behavioural Implications and Incentives

On behavioural implications and incentives, it has been noted that the introduction of social pensions distorts work and saving behaviour. People are less likely to save if they know they will be taken care of financially when they are older. It brings about moral hazard.

“...it has been held that the prospect of a pension for their closing years will disincline the poor to make or continue the exertions that many of them make at present for their own support, and that the considerations which induce to industry and thrift will cease to operate in future.” (UK Parliament 1899).

This effect is related to the size of the benefit in that, the larger the expected benefit, the greater the moral hazard as people are even less likely to put effort at work and in saving. Bertrand, 2001 in a study of the South African social pension scheme observed that labour supply declined with pension income to a household.

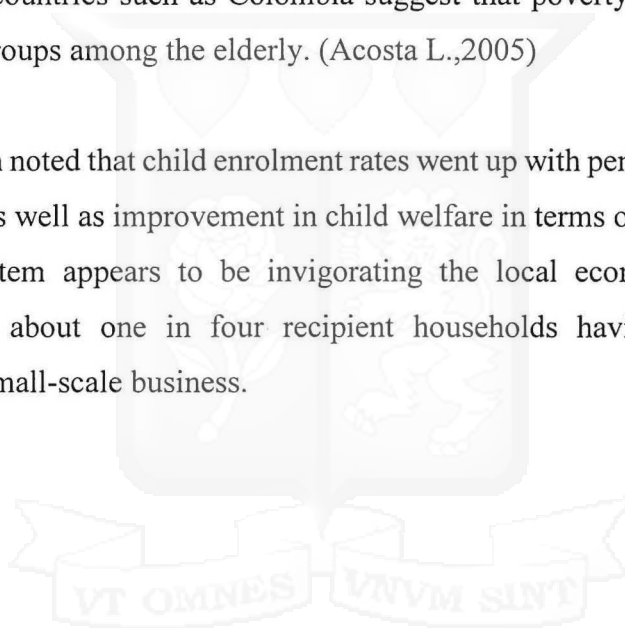
Another behavioural change that has been noted, albeit subtly, is the reduction in family support. Cox and Jimenez (1992) document a reduction in private informal money transfers to the elderly in Peru by 37% where the elderly received public social assistance.

#### 2.4.3 Poverty Alleviation and Economic Growth

Poverty alleviation among the elderly is the main driving force behind introduction of a social pension program. In as far as studies have been done, generally, poverty levels among the elderly have gone down with the introduction of pension benefits. Empirical evidence from Latin American countries such as Colombia suggest that poverty rates are lower than other population sub-groups among the elderly. (Acosta L.,2005)

It has further been noted that child enrolment rates went up with pension income to a household in South Africa as well as improvement in child welfare in terms of nutrition.

The pension system appears to be invigorating the local economy in Namibia through investment with about one in four recipient households having invested in livestock, agriculture or a small-scale business.



## CHAPTER 3

### 3 METHODOLOGY

#### 3.1 Introduction

This section is going to highlight some of the processes and techniques used to carry out this research study. It will also give justification for the methods and procedures used and use this raw data to arrive at meaningful results and findings in the next chapter. Techniques used in data collection and analysis are explained in greater detail in the coming sections.

#### 3.2 Research Design

The nature of this research study is experimental in a theoretical way since the paper seeks to explore the feasibility of introducing a social pension scheme in Kenya and even predict the fiscal repercussions of such a scheme. Such a scheme does not yet exist in Kenya (it has not been fully implemented as it is still in its pilot stage), however, using case studies from other countries of similar socio-economic characteristics, the research study investigates the possibility of introducing such a program. Hence, the country's Gross Domestic Product (GDP), Per Capita and demographics data will be used in estimation of pension benefits to the elderly poor.

#### 3.3 Population

The population of Kenya at national level is used in calculation and estimation of figures for the purpose of this research study. Population projections from KNBS from year 2009 to 2030 will be used. These projections are made based on previous national census surveys. Mortality projections were based on projecting future expectation of life at birth. Expectation of life at birth was assumed to increase from 58.5 for males and 61.6 for females in 2010 to 65.3 and 69.5 in 2030 respectively. This was based on the fact that both the 2008/09 Kenya Demographic Health Survey and the 2009 Census had shown improvement in infant and child mortality. (KPHC, 2009)

### 3.4 Data Collection Methods

Secondary data is used in this research study as it was readily available from credible sources. Data on population statistics and demography was sourced from the Kenya National Bureau of Statistics. Data on Kenya's GDP was obtained from the World Bank's archives.

Table 2: Summary of Kenya's Projected Population by Different Categories

Indicator	2010	2015	2020	2025	2030
Projected total population (million)	38.5	44.2	50.3	57	63.9
Projected population age 15-24 (million)	8.1	8.9	9.9	10.9	12.5
Projected total population under age 15 (million)	16.2	18.4	20.8	23.5	25.8
Projected female population age 15-49 (million)	9.5	11.0	12.7	14.4	16.4
Projected population age 60 and above (million)	1.9	2.0	2.3	2.8	3.4
Projected pre-school age population (million)	3.5	3.9	4.6	5.0	5.4
Projected primary school age population (million)	8.2	9.0	10.2	11.8	13.0
Projected secondary school age population (million)	3.5	3.9	4.4	4.8	5.7
Projected population age 15-64 (million)	20.8	24.5	28.5	32.9	37.8
Projected number of households (million)	10.1	12.0	13.9	NA	NA

NA – Not available

Source: 2009 Kenya Population and Housing

### 3.5 Research Procedure

The research process for this paper entails calculating the amount of money that the government needs to set aside each year for the social pension program. From tables 2, 3 and 4, Kenya's population is set on an upward trend and so is the GDP.

Simple annuity calculation methods and formulas are used to estimate how much money will be required each year to fund the social pension scheme.

Assumptions:

Retirement age = 60 years

Time horizon = 25 year

Known Variables:

Annuity paid per month – pension benefit

Number of persons over 60 years

Population growth of persons over 60 years

Inflation rate

Expected pension benefits will be discounted to year 60 over a 25 year period using Excel functionalities. The model needs to be adjusted each year to reflect the inflation rate and the population growth of persons over the age of 60.

### 3.6 Chapter Summary

To evaluate the success of the social pension program, it must be tested and proven to exhibit the following characteristics;

**Affordable** - It must be affordable to the contributing members in the case of a contributory scheme and affordable to society and the government in the case of a social pension program. It must not come at a high cost to other economic or social sectors. (Low fiscal trade-off)

**Sustainable** - It must be financially sound and it should be projected over a long time horizon.

**Adequate** - Pension benefits must be inclusive of the entire population that have a right to it. It should provide a reasonable replacement of income during old age.

**Robust** - Capable of withstanding economic shocks and should be projected to absorb major changes in demographic trends without folding in.

## CHAPTER 4

### 4 DATA ANALYSIS AND RESULTS

#### 4.1 Introduction

There is no doubt that there will be many benefits with the introduction of a universal social pension in Kenya. However, much depends on how the program is implemented and managed and how potential challenges can be avoided and eliminated. The fiscal affordability and sustenance of the program is one of the key areas of interest for policy makers. A universal social pension is an effective tool in mitigating old age poverty but it comes at a great fiscal cost. Müller (2009) highlights this facts and notes that the social pension program in Lesotho is one of the most expensive programs in the country even though it only covers 4.4% of the population.

The fiscal cost is a crucial measure for policy makers and significant studies and research is being carried out to better understand it. ILO and Help Age International carried out simulations of the fiscal cost of social pensions among several developing countries and concluded that on average, a social pension program will take up 1% of a country's GDP. This, they assume, is affordable and sustainable. However, data from countries that actually have these programs suggest that the fiscal cost is higher. South Africa, for instance, spends 1.7% of GDP on its social pension, with Seychelles and Mauritius spending 2% and 2.2% respectively.

#### 4.2 Data Analysis

Kenya's Gross National Income per capita is estimated at about \$1,290 according to World Bank. Assuming USD 1 = KES 100, this roughly translates to 129,000 shillings per year, and 10,750 shillings per month. With over 40% of the country's population living on one dollar a day, the above estimates are quite generous for many people.

In determining the annuity amount that will be paid to elderly citizens above the age of 60, three annuity levels were used and against each, the fiscal cost in terms of percentage of GDP was observed. Currently, the Kenyan government plans on introducing a program that will give KES

4,000 bimonthly to senior citizens over the age of 70. The program is set to begin in January 2018. This amount (KES 2,000 per month) is on the lower side and it means, these households will still be living below the poverty line.

Figure: Table a

	2010	2015	2020	2025	2030	Annuity per person per month, KES	2000
Projected Population age 60 and above (mil)	1.9	2	2.3	2.8	3.4	Annuity Per person, per annum, KES	24000
Population growth every 5 years (%)		5.26%	15.00%	21.74%	21.43%	Inflation rate	0.05
Population growth annually		1%	3%	4%	4%	Population growth rate	0.005
GDP US\$ Billions	40	63.7	76.18	81	85.86		
Annual Cash Transfer in millions, KES	45600	48000	55200	67200	81600		
Annual Cash Transfer in Billions, US \$	0.456	0.48	0.552	0.672	0.816		
Percentage of GDP	1.1400%	0.7535%	0.7246%	0.8296%	0.9504%		
Percentage of GDP adjusted	1.20299%	0.79516%	0.76463%	0.87547%	1.00289%		

At an annuity level of KES 2,000 per month, the fiscal cost of the program will be roughly at under 1% of GDP, given all other factors remain constant; that is, no spikes in the population growth rate and the GDP continues to increase at its current level of 5% - 6% per annum. (See Table a)

Figure: Table b

	2010	2015	2020	2025	2030	Annuity per person per month, KES	3500	
Projected Population age 60 and above (mil)	1.9	2	2.3	2.8	3.4	Annuity Per person, per annum, KES	42000	
Population growth every 5 years (%)		5.26%	15.00%	21.74%	21.43%	Inflation rate	0.05	1.05
Population growth annually		1%	3%	4%	4%	Population growth rate	0.005	1.005
GDP US\$ Billions	40	63.7	76.18	81	85.86			
Annual Cash Transfer in millions, KES	79800	84000	96600	117600	142800			
Annual Cash Transfer in Billions, US \$	0.798	0.84	0.966	1.176	1.428			
Percentage of GDP	1.9950%	1.3187%	1.2680%	1.4519%	1.6632%			
Percentage of GDP adjusted	2.10522%	1.39154%	1.33811%	1.53207%	1.75506%			

The second scenario (Table b) sets the annuity level at KES 3,500 per month. This elevates the households to just over a dollar a day. The fiscal costs increase significantly to 1.3% to 1.75% of GDP.

Figure: Table c

	2010	2015	2020	2025	2030	Annuity per person per month, KES	4500	
Projected Population age 60 and above (mil)	1.9	2	2.3	2.8	3.4	Annuity Per person, per annum, KES	54000	
Population growth every 5 years (%)		5.26%	15.00%	21.74%	21.43%	Inflation rate	0.05	1.05
Population growth annually		1%	3%	4%	4%	Population growth rate	0.005	1.005
GDP US\$ Billions	40	63.7	76.18	81	85.86			
Annual Cash Transfer in millions, KES	102600	108000	124200	151200	183600			
Annual Cash Transfer in Billions, US \$	1.026	1.08	1.242	1.512	1.836			
Percentage of GDP	2.5650%	1.6954%	1.6303%	1.8667%	2.1384%			
Percentage of GDP adjusted	2.70672%	1.78912%	1.72043%	1.96980%	2.25651%			

Table c sets the monthly annuity to KES 4500 per month and the corresponding fiscal costs will require over 2% of GDP to go into sustaining the program.

Another way to better assess the magnitude of a social pension program is to compare it against the total government spending. In this case, the Kenyan budget for the year 2017/2018 stands at USD 22 billion. Taking the annual cash transfer in billions US \$ for the year 2020 for instance, each of the three scenarios give 2.5%, 4.4% and 5.65% of total government expenditure respectively.

#### 4.3 Interpreting the Results

For the above results, a lot of assumptions have been made. For instance, the level of inflation has been assumed to remain constant for the foreseeable future. Also, the population growth rate for persons over the age of 60 has been held constant. In a real life situation, these values are expected to vary and this may produce different results other than what has been presented here. The annuity values or the cash transfer amounts are also fixed. This is usually the case with a universal social pension. Some countries like South Africa use a means-tested approach whereby, the benefits are only available to elderly persons whose income is below a certain level.

We can however, infer from the results that generally, implementing and running such a program especially in developing nations that have limited fiscal resources, is costly and in the long run, it may create a real financial burden given the great extent of poverty levels.

It is worth noting, however, that in countries like South Africa and Mauritius, which have experience with such social security programs, their fiscal cost account for almost 20% of government spending. This is to say that, one-fifth of all government spending in these two countries goes to support the aging population. They also have good coverage of 60% or more. In the three scenarios that were presented above, the highest percentage of government spending that would go to a social pension program in Kenya, would only take 5.6% of government spending. While this figure is not insignificant, and it definitely represents a large share of total expenditure, it pales in comparison when matched with 20% from South Africa and Mauritius.

Countries whose populations are projected to age faster will face a greater fiscal burden unless their GDP keeps growing, otherwise, sustainability will be impossible.

## CHAPTER 5

### 5 DISCUSSION AND RECOMMENDATION

#### 5.1 Financing Social Pensions

There are three ways that the government can use to finance a universal social pension. One, raise more government revenue through increased taxation, reduce government spending on some sectors (fiscal trade-off) and three, external donor financing. Optimizing public spending is the best tool in financing such a program as tax revenues in low income countries has remained generally low and constant over the last two decades.

In many cases, the government bears the cost of financing a social pension explicitly. Policy makers are thus faced with finding out the scope of the budgetary requirements, for both short term and long term needs. How then, can they create fiscal space to accommodate social pensions? Creating sound macroeconomic policies is the first step towards achieving this goal. Raising additional revenue through indirect taxes has been proposed by Keen and Mansour (2008). Rationalization of government spending through evaluation of the merits of different public programs and optimizing the use of resources each of these programs.

#### 5.2 Challenges in Administration of Social Pensions

Implementation and administration challenges plague many cash transfer programs around the world. Absence of a reliable database and information system is one of the greatest challenges. Without a proper management system, elderly individuals may miss out on their benefits and in the case where one is deceased, the administrators may continue paying the benefits because the death was not reported and filed. Beneficiaries may also miss out on benefits if they have no means to prove that the recipient is deceased.

Fraud is also a common challenge because most elderly individuals could be illiterate and thus vulnerable to exploitation by cons. Mobility issues especially in remote rural areas may pose as a big problems as it may inhibit elderly individuals from accessing banks and other payment centers.

Delays at pay points due to system failures, lack of necessary identification papers, inability to verify age and a shortage of local government staff for administration were some of the challenges reported in Uganda and Zambia.

Targeting errors are also common especially where a means testing approach is used. Moreover, budgetary constraints could lead to coming up with solutions that involve a narrower means testing approach, which could mean that some vulnerable groups miss out on the cash transfer assistance.

### 5.3 Recommendations for Kenya

Given the above simulation, results and findings, this report seeks to strongly recommend the introduction and implementation of a government funded universal social pension for all persons over the age of 60 years in Kenya. Other recent simulations carried out in multiple Sub Saharan Africa countries have proved that such a program will cost around 1% to 2% of GDP, which is manageable and sustainable for middle income developing countries. Kenya was recently elevated to the status of a lower-middle income country by World Bank. The country's economy is predicted to continue growing at a rate of 5% per annum. Kenya stands a chance at successfully implementing such a social program in the long run.

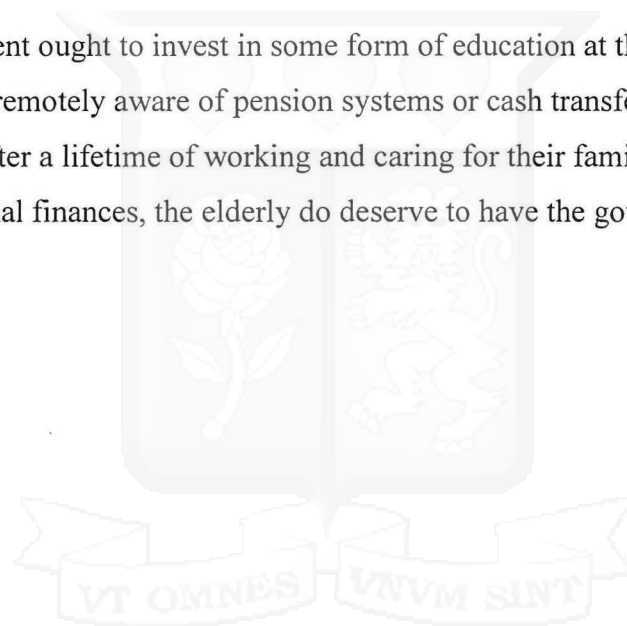
Kenya's pilot test for the cash transfer program is said to employ both means testing approaching and the universal benefits approach. Under universal benefits approach, the only eligibility criteria is age. For many researchers, this is the superior approach as it is simpler and easier to administer and deliver. It is also considered equitable as it provides everyone with a minimum income security once you attain the given age. By all means, it avoids the stigma and exclusion that is common with the means tested approach.

So far, the Kenyan government is involved with several cash transfer programs, namely; Hunger Safety Net Program, Older Persons Cash Transfers, Orphans and Vulnerable Children Cash Transfers and Persons With Severe Disabilities Cash Transfers. In July 2017, the Cabinet Secretary of the Ministry of East African Community, Labour and Social Protection, Mrs Kandie, launched "*Inua Jamii 70 years and above*" cash transfer program. It is not clear whether the latest inception is meant to expand on the pilot test program or they will be two separate

programs. To avoid fraud and double receipt of benefits, the government should consider merging these programs.

The government should also invest in creating an up to date data registry. It is hard enough to administer any form of cash transfer, especially in rural areas where people may not even have national Identity Cards. The program that is set to be implemented in 2018 seeks to deposit the cash benefits into recipients' bank accounts, however, this will be impossible in most rural areas as there could be a shortage of bank branches or the recipients may not even have bank accounts. The use of mobile money would be a much preferred solution though this still requires an updated registry.

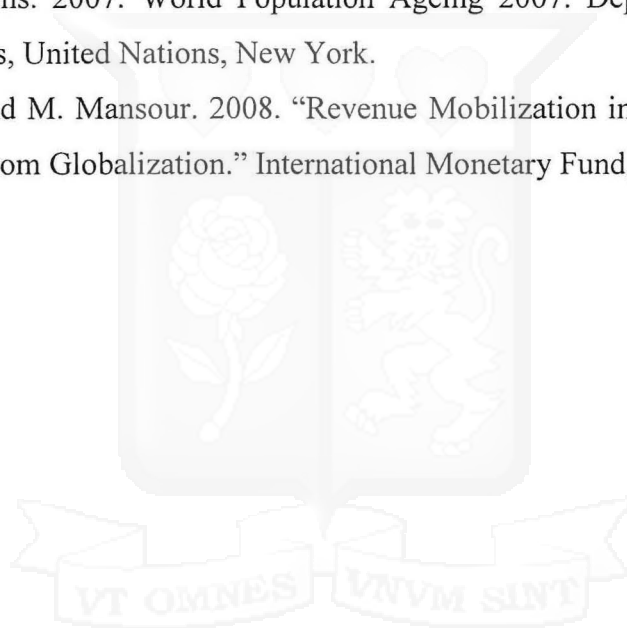
Lastly, the government ought to invest in some form of education at the grassroots. A lot of people are not even remotely aware of pension systems or cash transfer programs for which they could be eligible. After a lifetime of working and caring for their families as well as having contributed to national finances, the elderly do deserve to have the government step in for them.



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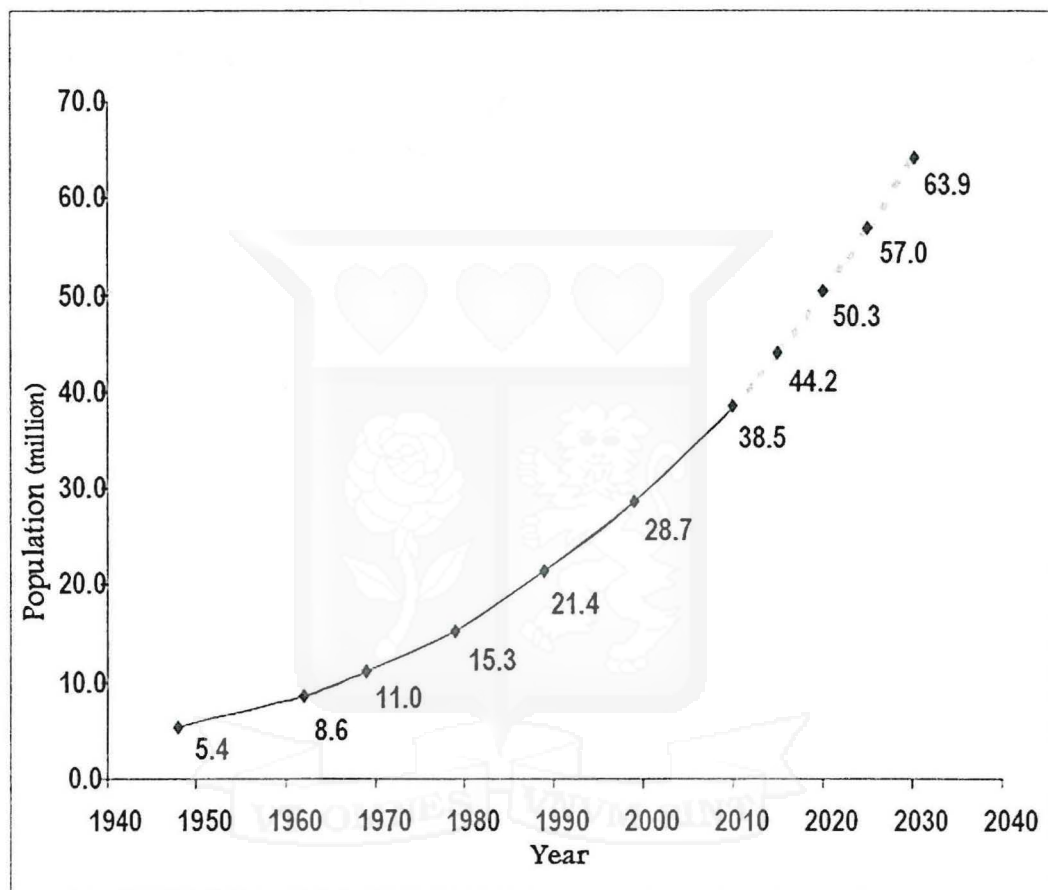
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APPENDICES

i. Table 3: Kenya's Projected Population

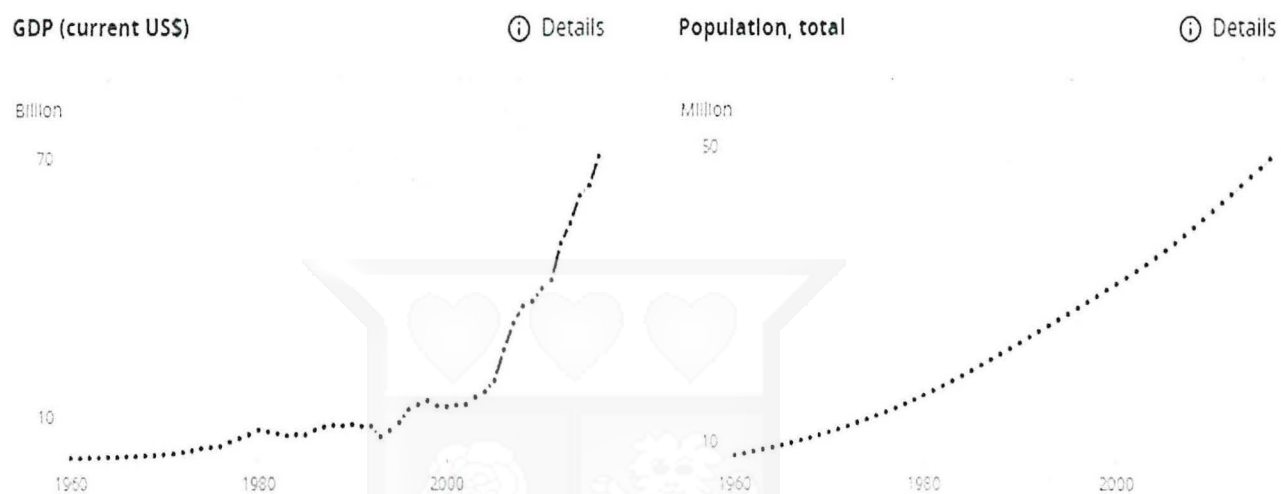
**Kenya's Population Growth, 1948-2030**



Source: 2009 Kenya Population and Housing

ii. Table 4: Side by Side Comparison of Kenya's GDP and Total Population

## Kenya ⓘ



Source: World Bank archives at <http://data.worldbank.org/country/kenya>