Overview of Public Pension Systems in Emerging Asia

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Introduction

- Old-age income support will be one of developing Asia’s biggest social and economic challenges in the 21st century.
- Social changes have weakened family-based old-age support mechanisms.
- Formal pension systems will have to play a bigger role.
- In contrast to OECD countries, Asia does not yet have mature, well-functioning pension systems.
- Many Asians are at risk of old-age poverty.
- Population ageing is an Asia-wide phenomenon, but there are major differences across sub-regions.
  - More advanced in East Asia and Southeast Asia than in South Asia
Demographic diversity across the region

Figure 1
Ratio of Population Aged ≥65 to Population Aged 15-64, 1950-2050

- China, People's Rep. of
- Korea, Rep. of
- Philippines
- Thailand
- Indonesia
- Malaysia
- Singapore
- Viet Nam
Overview of Asian pension systems

- We now examine the pension systems of 8 countries.
- The basic structure of pension systems is diverse and reflects each country’s constraints and preferences.
- Key pension parameters such as pension age and contribution rates vary across economies.
### Diversity of key pension parameters

#### Table 1. Pension Age and Basic Structure of Pension Systems, 2012

<table>
<thead>
<tr>
<th>Economy</th>
<th>Pension Age (Years)*</th>
<th>Difference between Life Expectancy and Pension Age (Years)</th>
<th>Pension Scheme</th>
<th>Income support for elderly poor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Male</td>
<td>Female</td>
<td></td>
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<tr>
<td>Developing Asia</td>
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<tr>
<td>China, People's Rep. of</td>
<td>60 (55)</td>
<td>14</td>
<td>17</td>
<td>Defined Benefit, Defined Contribution (funded or notional)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>55</td>
<td>12</td>
<td>16</td>
<td>Defined Contribution**</td>
</tr>
<tr>
<td>Korea, Rep. of</td>
<td>65</td>
<td>13</td>
<td>20</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>Malaysia</td>
<td>55</td>
<td>17</td>
<td>22</td>
<td>Defined Contribution</td>
</tr>
<tr>
<td>Philippines</td>
<td>65</td>
<td>5</td>
<td>9</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>Singapore</td>
<td>65</td>
<td>15</td>
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</tr>
<tr>
<td>Thailand</td>
<td>55</td>
<td>16</td>
<td>23</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>60 (55)</td>
<td>11</td>
<td>20</td>
<td>Defined Benefit</td>
</tr>
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<td>Advanced Economies</td>
<td></td>
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<tr>
<td>Australia</td>
<td>67</td>
<td>13</td>
<td>17</td>
<td>Defined Contribution</td>
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<tr>
<td>Japan</td>
<td>65</td>
<td>15</td>
<td>21</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>United States</td>
<td>67</td>
<td>9</td>
<td>14</td>
<td>Defined Benefit</td>
</tr>
</tbody>
</table>

**Note:**
*Refers to public pension schemes, except for Australia which is a private pension plan.
*Enclosed in parenthesis is the pension age for women.

**In June 2015, a defined benefit scheme was introduced in Indonesia, with retirement age at 56 gradually increasing to 57 in 2019, and by an additional year every 3 years until NRA is 65.

Source: OECD (2013); ADB (2011).
Diagnosis of Asian pension systems

- The biggest challenge for Asian pension systems is limited coverage.
- The share of the labor force which is covered by pension systems ranges from 11% to 84%.
- The coverage rate for working-age population ranges from 8% to 64%.
- In advanced economies, pension systems typically cover around 90% of the labor force and between 60% and 75% of the working-age population.
- Even in high-income Asian countries such as Korea, coverage falls well short of developed-country levels.
Limited coverage as a challenge

Figure 2. Share of Labor Force and Share of Population Aged 15-64 Covered by Pension Systems

Note: Years are between 2009 and 2012 for developing Asian economies and 2005-2009 for advanced economies.
Adequacy of retirement income as another challenge

Figure 3
Replacement Rate—Ratio of Retirement Income to Pre-Retirement Income, 2012

China, People's Rep. of
Viet Nam
Thailand
Korea, Rep. of
Singapore
Philippines
Malaysia
Indonesia

Men
Women

%
Way forward: country-specific reforms

- The review of Asian pension systems makes it clear that there is an urgent case for pension reform.

- Without major reform, the region’s pension systems cannot deliver adequate old-age income support in the face of population aging and structural shifts.

- Given the great deal of heterogeneity among the eight countries, we can expect the policy options for pension reform to differ substantially across countries.
Way forward: PRC-specific reforms

- Improve transparency and governance
  - For both state and private sector systems
  - Government to make timely and accurate information widely available
- Extend pension participation
- Raise normal retirement age (NRA)
  - First step is to raise female NRA to age 60
  - Make actual retirement age flexible, but with fully enhanced pensions for late retirement and appropriately reduced pensions for early retirement.
  - Then gradually raise NRA for both males and females to age 65 over the next 25 years.
Way forward: Asia-wide reforms

- Given wide disparity in income levels and existing pension systems, different countries will have different priorities in pension reform.
- Still, there are common themes which emerge from the analysis of the eight countries.
- The eight reforms have been arranged in terms of urgency, with the first being the most urgent.
Way forward: Asia-wide reforms

1. **Draw up a national blueprint for old-age income support**
   - Replace the current fragmented provisions with an integrated, coherent and viable system for old-age income support.
   - Spell out the overall vision of how a country plans to cope with the challenge of providing for the growing number of elderly.
   - Take into account country-specific factors such as the current state of the support systems and their main problems, society’s preferences about the appropriate division of risk between individual, employer and state, overall income and development level, the political economy environment, and the current and projected age structure of the population.
   - Need for top level political leadership to provide unity of direction and efficient enforcement of old-age income support policies.
Way forward: Asia-wide reforms

2. Build a national consensus on old-age income support through constant dialogue

- Government should take the lead in moving the issue of old-age income support to the center of public consciousness and public debate.
- Government should also inform the debate by communicating relevant knowledge and information.
  - An example is the costs of failing to undertake unpopular but necessary reforms such as raising the retirement age.
  - To foster greater participation in pension systems, the government should educate the public about the risks of myopia and the benefits of saving for retirement.
- The national consensus would contribute to the establishment of the national blueprint and efficient enforcement of retirement policies under the blueprint.
**Way forward: Asia-wide reforms**

3. **Set up an independent National Social Security Council (NSSC)**
   - NSSC can play a key role in building and maintaining a strong national consensus behind a sensible and viable national blueprint.
   - NSSC can be both an advisory and research body, and should be independent of government ministries, employer associations, labor unions, and other stakeholders.
   - NSSC could push through reform efforts on a permanent basis through advocacy, dialogue and communication, and protect the pension reform process from undue political interference motivated by short-term political gain.
   - The NSSC should also monitor the adequacy of the regulatory framework, the efficiency of the supervision, and the quality of the professional expertise supporting the operation of the systems.
Way forward: Asia-wide reforms

4. Improve transparency, accountability and professionalism

◦ Pensions are ultimately promises to provide old-age income in the distant future in exchange for contributions today.

◦ Public trust and confidence is therefore important in building up pension systems.

◦ Pension authorities such as the NSSC should publicize the pension system and educate the public about its key features.

◦ The pension system should be managed with a high degree of transparency and accountability.

◦ Enhance professionalism, including more integral and strategic use of information technology and management information systems in the performance of core functions such as collection of payments and payment of benefits.
Way forward: Asia-wide reforms

5. Promote equity and sustainability

◦ There are disparities among population groups in terms of coverage, level of net benefits and retirement age. In particular, civil service and military pensions tend to pay more generous benefits than those received by the rest of the population.

◦ Gradual reduction of such disparities will increase the general public’s sense of ownership in pension systems and thus strengthen popular support for pension reform.

◦ Many of developing Asia’s pension systems, especially those based heavily on defined benefit schemes, are unsustainable in the long run. Without significant reforms, the financial burden on future workers will reach levels likely to generate a great deal of resistance. Therefore, achieving an acceptable degree of inter-generational equity benefits both future workers and future retirees.

◦ A high-priority reform area is raising the retirement age, given fast-rising longevity. In some cases, the contribution rate will have to be raised substantially.
Way forward: Asia-wide reforms

6. Achieve adequate retirement income
   ◦ Expanding coverage is a first step for securing adequate retirement income for the widest possible segment of the population.
   ◦ However, it is costly for the main pension system to cover everyone, so supplementary arrangements such as social pensions for the elderly poor are still required.
   ◦ Ensuring adequate retirement income dictates that individuals assume greater responsibility for their own retirement needs. This can involve supplementing a national defined benefit scheme for basic needs with a defined contribution scheme based on individual earnings.
   ◦ Specific additional measures to boost adequacy include raising contribution rates, limiting early withdrawals for non-retirement uses, converting lump sum into annuities and taking innovative approaches to designing pay-out during retirement, improving the operating environment for providers of private pensions, and enhancing portability.
Way forward: Asia-wide reforms

7. Mitigate old-age poverty
   ◦ Rapid population aging, in combination with inadequate old-age income support systems, is heightening the risk of widespread old-age poverty.
   ◦ An important first step toward tackling old-age poverty is to define the problem. The income level required for a minimum standard of living should be clearly defined and its definition should be periodically reviewed.
   ◦ Social pensions financed out of the government budget should aim to provide the elderly poor with the minimum income. Ideally benefits must be means-tested and target only those who need them.
   ◦ In some cases, it may be more practical to set up universal basic pension schemes which guarantee a minimum standard of living for all elderly and rely on the tax system to improve equity.
   ◦ The protection of dependent spouses is another priority area in fighting old-age poverty.
Way forward: Asia-wide reforms

8. Improving returns on pension assets

- In principle, realizing higher returns on the assets of pension systems provides a relatively painless avenue for boosting adequacy since this does not require major trade-offs. Overall there is a significant scope for improvement in the returns performance of developing Asia’s pension systems.

- Preceding the need for high returns is a strong prudential framework which would inspire public trust in the management of pension assets. Related to this, the diversion of pension funds for ad hoc fiscal uses should be minimized, and preferably eliminated altogether.

- Investment functions should be separated from administrative functions, and performed by professional investment managers.

- If there is adequate institutional capacity, the managers can invest in a more diversified investment portfolio to raise returns.

- Simple measures such as reducing administrative costs can increase the level of pension benefits, which is the most relevant measure of returns.
Final observations

- **Pension reform must be part of policy package**
  - Take into account the overall socio-economic context and overall policy environment in the pension reform process.
  - For example, the underdeveloped financial markets constrain ability of pension system’s investment managers to improve returns of investments. Thus, policies which promote financial development are complementary to pension system reforms aimed at improving returns.
  - Need for fiscal reforms to provide incentives for retirement savings and to safeguard pension assets, and health care reform to deliver affordable health care for the elderly.

- **At the same time, pension reform can also reinforce and speed up reform in other areas.**
  - Portability of pensions contributes to greater mobility of workers and hence a more flexible labor market.
  - Fully funded schemes can contribute to bigger, deeper and liquid financial markets. Such schemes can complement financial market reforms such as strengthening the legal and regulatory framework.
  - Pension reform can also serve as a catalyst for health care reform.