

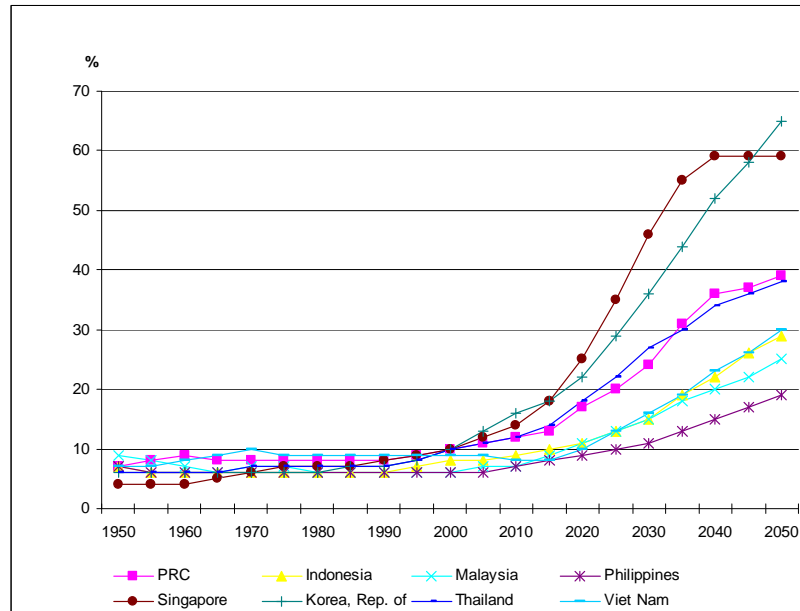
Promoting Fairness and Sustainability of Pension Systems in East and Southeast Asia

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Introduction

- Demographic change poses two huge socio-economic challenges for developing Asia
 - Sustain rapid growth in the face of less favorable demographics
 - Demographic dividend is set to decline
 - Deliver affordable, adequate and sustainable old-age economic security
 - Region's fast-growing elderly population makes this imperative
- The two strategic objectives sometimes come into sharp conflict with each other, and necessitate tough trade-offs
 - For example, expansion of public transfers to the elderly will reduce fiscal resources for health, education and infrastructure which affect growth

Ratio of elderly to working—age population, 1950-2050



Basic structure of pension systems

Country	Pension Age (Years)	Difference Between Life Expectancy and Pension Age (Years)		Defined Benefit or Defined Contribution	Element of Income Redistribution
		Male	Female		
China	60 (55)	11.3	19.8	Defined Benefit, Defined Contribution, and Notional Defined Contribution	Yes
Indonesia	55	13.7	17.7	Defined Contribution	No
Korea	65	10	17.2	Defined Benefit	Yes
Malaysia	55	17	21.7	Defined Contribution	No
Philippines	65	4.5	8.9	Defined Benefit	Yes
Singapore	62	16	19.9	Defined Contribution	No
Thailand	55	11.5	20	Defined Benefit	No
Vietnam	60 (55)	12.3	21.2	Defined Benefit	No

Fairness

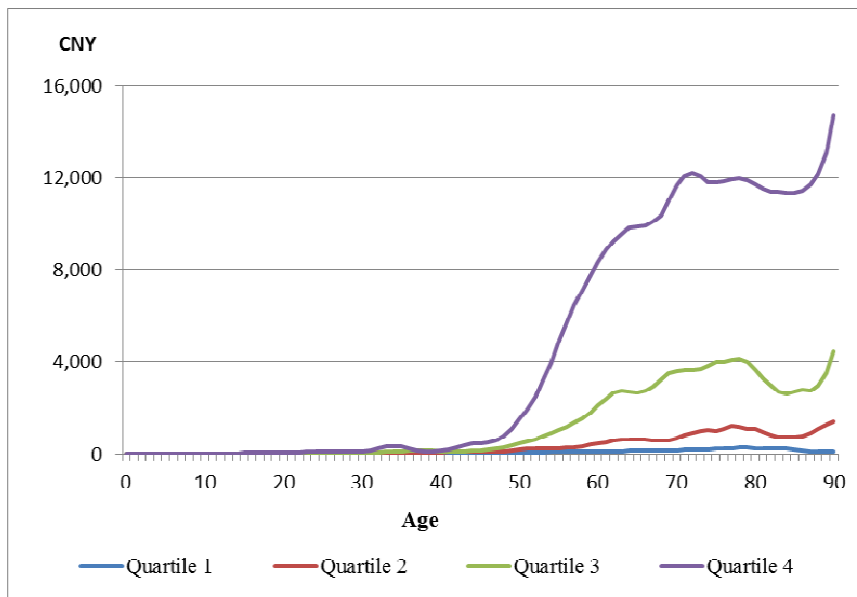
- There is a great deal of disparity in terms of coverage, level of net benefits, and retirement age.
- For example, to attract personnel into the civil and the military service, their pension benefits are often more generous than those of the rest of the population.
 - In some cases, beneficiaries contribute relatively little into these systems further enhancing their net benefits to the extent that they can pose a risk to fiscal sustainability
- Another major disparity is between urban and rural areas
- Intra-generational disparities also arise between the formal and informal employment sectors

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Per capita public spending on health by income quartile



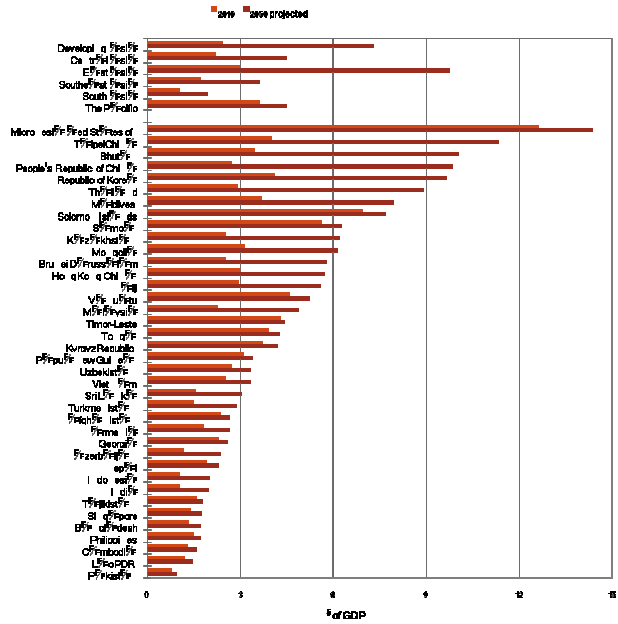
Per capita public spending on pensions by income quartile



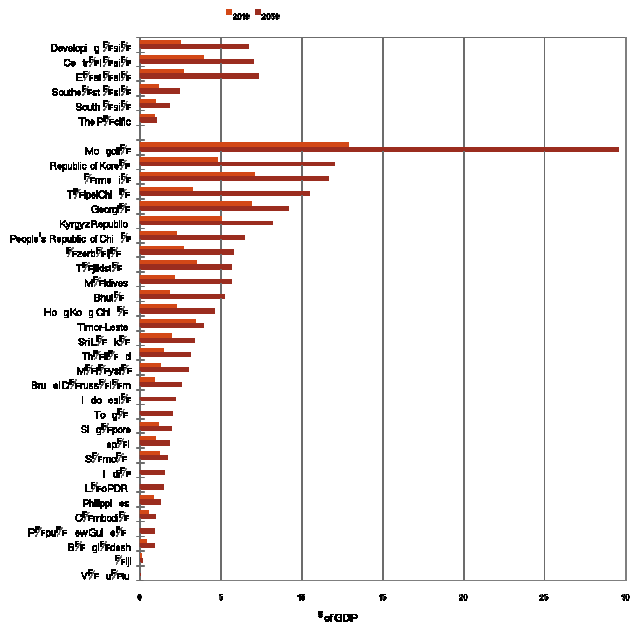
Sustainability

- If fairness deals with intra-generational disparities, sustainability addresses inter-generational disparities.
- In Asia, as in other parts of the elsewhere, defined benefit pension schemes tend to be pay-as-you-go and are not sustainable in the long run
 - Little or no link between contributions and benefits
- Without far-reaching reforms, the financial burdens of these schemes on future workers may become politically unacceptable
 - Fundamental reforms include raising retirement ages to reflect rapidly increasing longevity and raising contribution rates

health



welfare

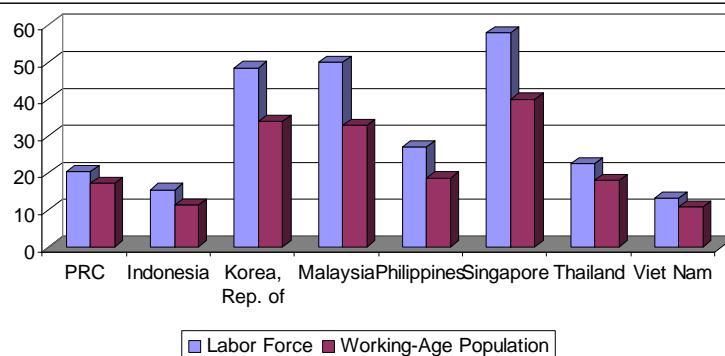


Adequacy

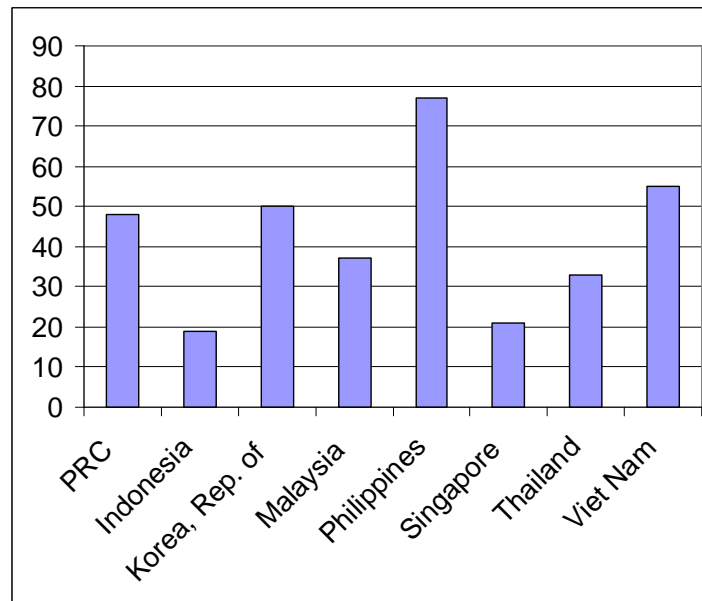
- The biggest failure of Asian pension systems is inadequate coverage - they *cover only a limited part of population*.
 - The share of the labor force which is covered by pension systems ranges from 13.2% to 58%.
 - The coverage rate for working-age population ranges from 10.8% to 40%.
- Asian countries also perform poorly with respect to the replacement rate, or the ratio of retirement income to pre-retirement income.
 - Replacement rate is a widely used measure of the adequacy of pension benefit as a source of post-retirement income.
 - Pension experts generally recommend a replacement rate of between 66 to 75%, adjusted for both longevity and inflation risks.

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Share of population and labor force covered by pension system



Replacement rate



Investment returns on pension assets

- Overall, there is significant scope for improvement of the investment returns performance of developing Asia's pension systems
 - In Asia, as elsewhere, realizing higher returns on the assets of pension systems provides a relatively painless avenue for boosting adequacy
- Weak prudential frameworks that fail to inspire public trust in the management of pension assets
- If there is adequate institutional capacity, the managers can invest in a more diversified investment portfolio – including greater investment in equities.
 - In the absence of such capacity, simple measures such as reducing administrative costs can increase the level of pension benefits, which is the most relevant measure of returns.

National consensus

- These disparities make building a national consensus for pension reform difficult because they dilute the general public's sense of ownership and thus weaken popular support for reforms
- Voluntary participation and compliance will not, however, be forthcoming if there are significant discrepancies in fairness
- Likewise, a lack of sustainability will undermine public confidence that the system can fulfill its fundamental promise to deliver benefits in the future
- Fairness and sustainability are thus indispensable for establishing a national consensus for pension reform

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Policy options - PRC

- Reform the pension systems of both civil servants and public service employees so that their pension arrangements are brought into line with the urban system
- Pay more attention to unsatisfactory investment returns
- Integrate the rural and urban systems in the second half of the century

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Policy options - Korea

- Alleviate the poverty of the current elderly population
- Extend the coverage of the national pension scheme
- Improve the long-term financial stability and inter-generational equity of the national scheme

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Policy options – Asia-wide

- Recognize the urgency of addressing the challenges posed by aging populations
 - It must be recognized that this is a major national issue that must be addressed now at the highest levels of government
 - There should be a clear mandate for developing an integrated set of policies to coordinate and synchronize initiatives on retirement, labor markets, budgets, and financial and capital market opportunities for pension and provident funds
 - This responsibility could be assigned to a minister/director who could consider forming a national authority to make recommendations for reform, monitor the results, and enforce policies designed to meet the aging challenge

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Policy options – Asia-wide

- Put greater emphasis on delivering pension benefits
 - It is of paramount importance to ensure that benefit promises remain credible over time. These promises are of a long-term nature, so the design and management of pension plans and provident funds, the quality of their actuarial projections for long-term assets and liabilities, and their transparency and accountability are crucial
 - Transitional arrangements, including costs, need consideration as well and will require innovative designs of schemes, products, and delivery systems
 - Policies must ensure not only the accumulation of sufficient pension wealth but also its effective conversion into sustainable financial security throughout retirement

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Policy options – Asia-wide

- Manage the impact of increased longevity on length of retirement
 - In most Asian countries, the proportion of life spent in retirement mandated by pension rules has increased significantly due to relatively inflexible young retirement ages
 - But this has yet to be recognized and has created unequal treatment for those not covered by formal plans. Inequality could also occur if workers currently not covered are covered by special schemes while the ages for pension eligibility remain at current levels
 - As the population ages, labor market policies must adapt to turn increased longevity into increased productivity in a structural rather than a palliative manner

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Policy options – Asia-wide

- 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. The old are especially vulnerable to long-term poverty since their ability to fully participate in the labor market remains limited.
 - An important first step toward tackling old-age poverty is to define the problem. In this connection, the national or local income level required for a minimum standard of living should be clearly defined but 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 the benefits must be means-tested and target only those who need them.
 - However, 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. Regardless of the exact modality of the transfer, fiscal sustainability dictates that the resources be transferred more efficiently and effectively. The protection of dependent spouses is another priority area in fighting old-age poverty.

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Policy options – Asia-wide

- Improve transparency, accountability and professionalism
 - Pensions are ultimately promises to provide old-age income in the distant future in exchange for contributions today. Therefore, beneficiaries are understandably less than fully confident that the promises will be kept. Public trust and confidence is of utmost importance in building up pension systems with widespread participation and compliance.
 - It follows that pension authorities should publicize the pension system to the public and educate the public about its key features. To inspire trust and confidence, the pension system should be managed with a high degree of transparency and accountability. Information about individual contribution records and projected benefit amounts and the management of pension assets should be readily available in a simple accessible format.
 - An important additional means of inspiring trust and confidence is to 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.

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