

# Public pension systems in emerging Asia: Challenges and reform efforts

Dr. Donghyun PARK,

Asian Development Bank ([dpark@adb.org](mailto:dpark@adb.org))

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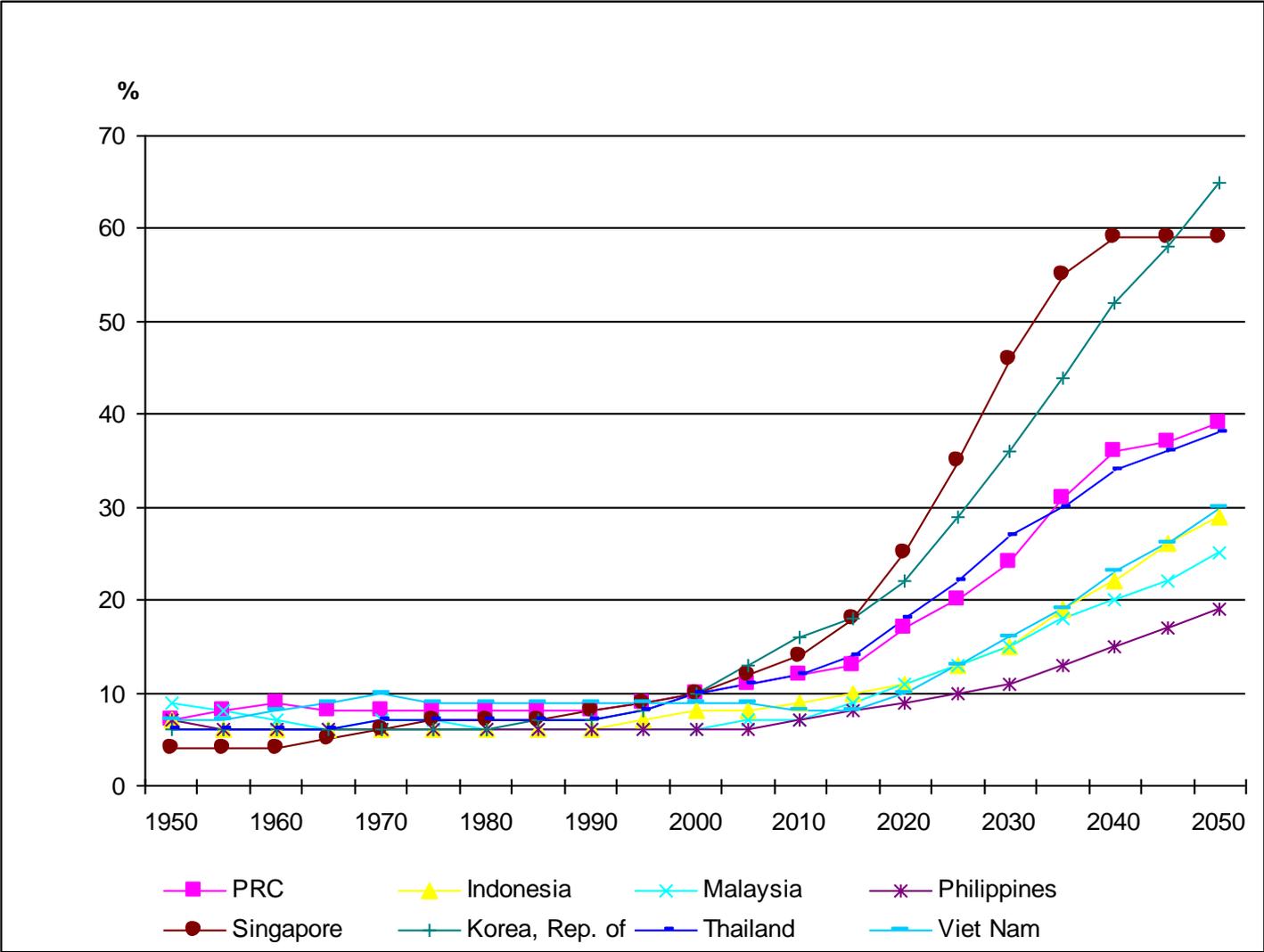
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# 1 Introduction

- Old-age income support will be one of developing Asia's biggest social and economic challenges in the 21<sup>st</sup> century.
- This is largely due to a seismic demographic transition – i.e. population ageing.
- 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
- In contrast to OECD countries, Asia does not yet have mature, well-functioning pension systems.

**Figure 1**  
**Ratio of Population Aged  $\geq 65$  to Population Aged 15-64, 1950-2050**



## 2 Overview of Asian pension systems

- We now examine the broad anatomy of the pension systems of the 8 countries.
- The basic structure of pension systems is diverse and reflects each country's constraints and preferences.
- There is considerable heterogeneity in terms of key pension parameters such as pension age and contribution rate.

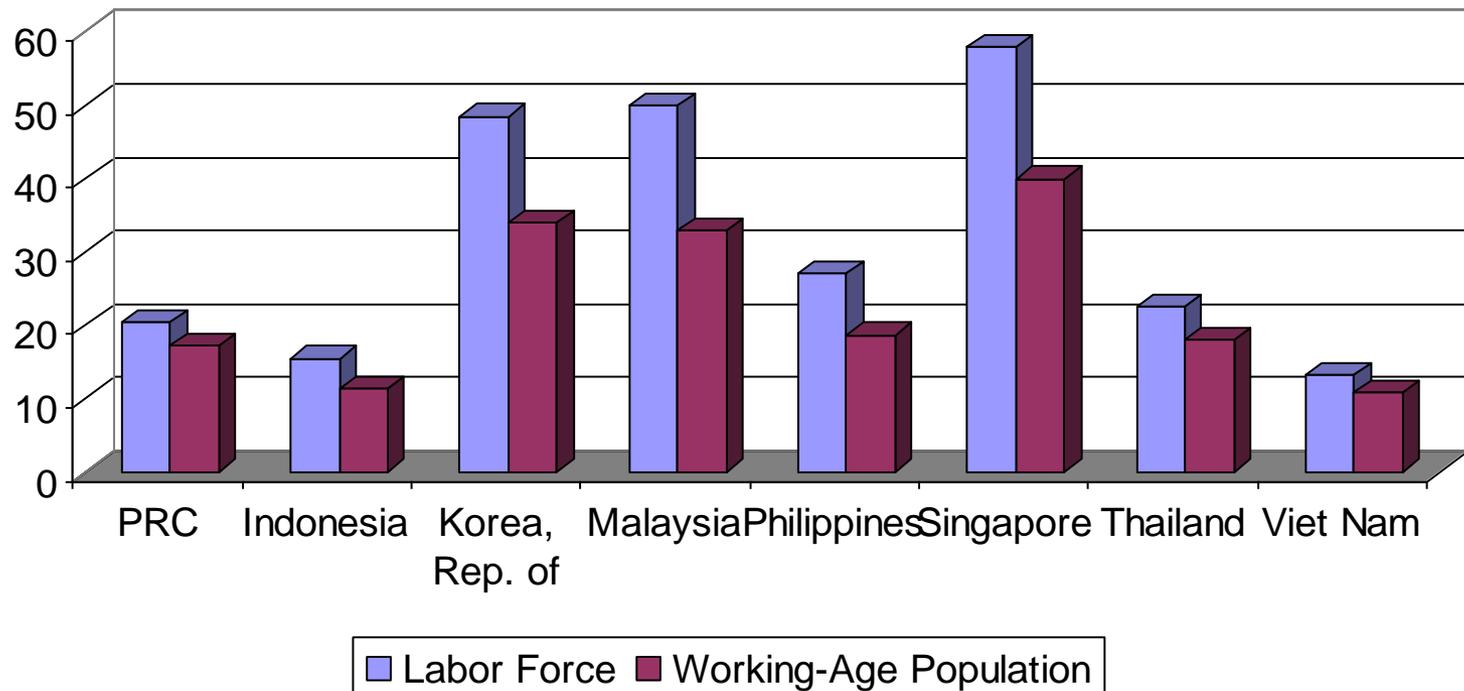
**Table 1**  
**Pension Age and Basic Structure of Pension Systems, 2007**

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

# 3 Diagnosis of Asian pension systems

- 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%.
- 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.

**Figure 2**  
**Share of Labor Force Covered by Pension Systems and**  
**Share of Population Aged 15-64 Covered by Pension Systems, 2007**

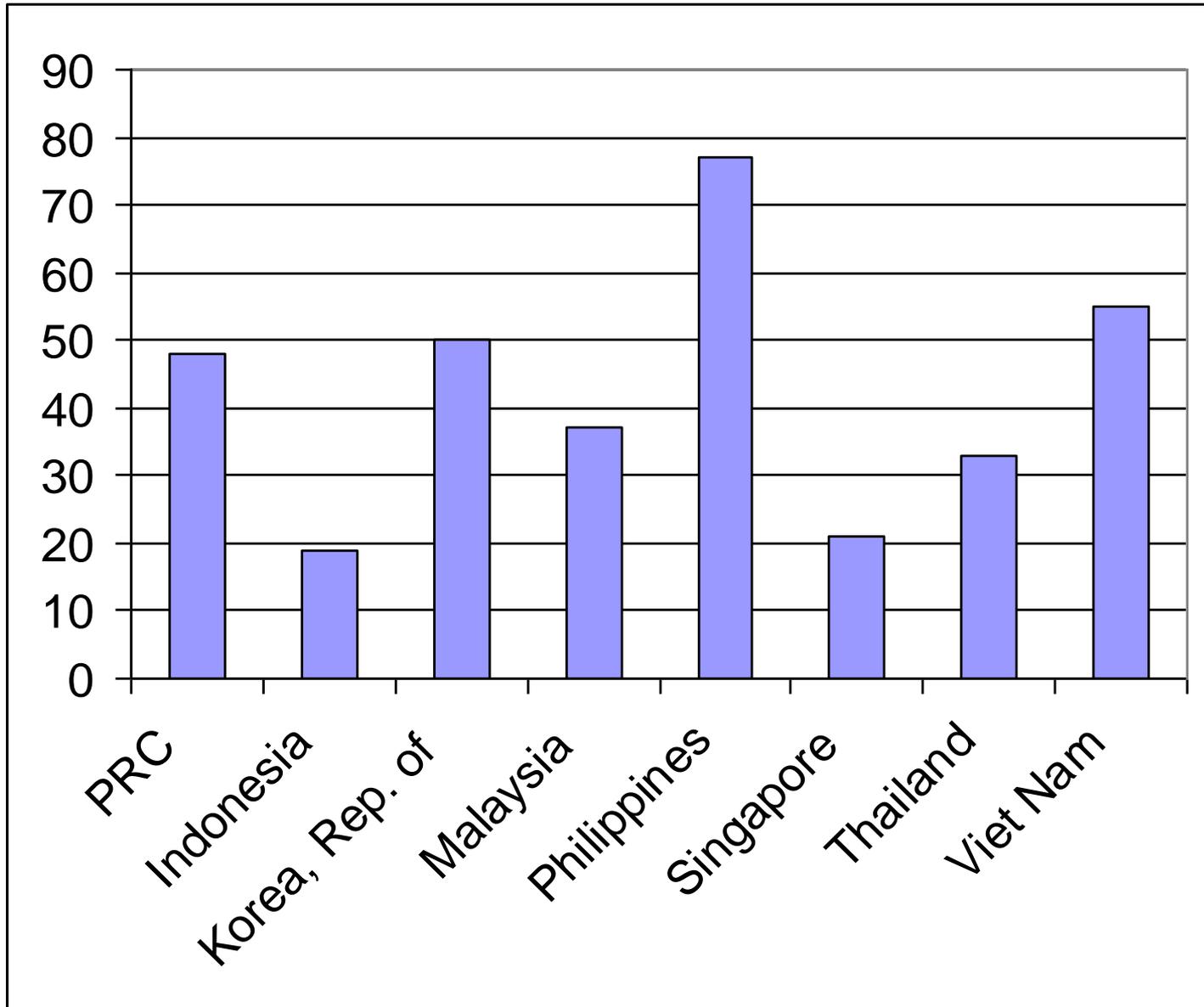


# 3 Diagnosis of Asian pension systems

- 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.

Figure 3 – ADB (2008)

Replacement Rate—Ratio of Retirement Income to Pre-Retirement Income, 2007



## 4 Way forward: country-specific reforms

- The diagnosis of the current state of Asian pension systems makes it abundantly clear that there is an urgent case for pension reform throughout the region.
  - Without major reform, the region's pension systems cannot deliver adequate old-age income support in face of population aging and structural shifts.
- Given the great deal of heterogeneity among the eight countries, both in terms of their overall socio-economic development and the development of their pension systems, we can expect the policy options for pension reform to differ substantially across countries.
  - Here we summarize the most salient country-specific policy options for building up stronger and better pension systems which can deliver economic security throughout

# 4 Way forward: PRC-specific reforms

- Improve transparency and governance
  - For both state and private sector systems
  - Government to make available timely and accurate information widely available
- Extend pension participation
  - Improve compliance in the urban system.
  - Proceed with implementation of the new Rural Pension System implementation.
- 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.

# 5 Way forward: Asia-wide reforms

- Given the wide disparity in the general income development level and existing pension systems, it is inevitable that different countries will have different priorities in pension reform.
- At the same time, a number of common themes which have resonance for pension reform throughout the region emerge from the analysis of the eight country chapters.
- We now outline some of those recurrent region-wide themes in pension reform.
  - In terms of the sequencing of pension reform in developing Asia, the eight reforms have been arranged in terms of urgency, with the first being the most urgent.

# 5 Way forward: Asia-wide reforms

- **Draw up a national blueprint for old-age income support**
  - Most East Asian countries currently have at least some provisions for old-age income support but these tend to be piecemeal and fragmented.
  - The first step toward in replacing the current patchwork of fragmented, piecemeal provisions with an integrated, coherent and viable system for old-age income support is to draw up a strategic national blueprint for old-age income support.
  - Such a blue print will spell out the overall vision of how the country plans to cope with the challenge of providing for the growing number of elderly.
  - The blueprint should 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.
  - Top level political leadership which provides unity of direction and efficient enforcement of old-age income support policies is

# 5 Way forward: Asia-wide reforms

- **Build a national consensus on old-age income support through constant dialogue**
  - The country chapters indicate that in most cases there is no systematic recognition of the challenge of old-age income support.
  - Furthermore, there is very little appreciation of the huge social and financial dimensions of the challenge, and no systematic strategy to address it.
  - The government, backed up by top level political leadership, should take the lead in moving the issue of old-age income support from the background to the front and center of public consciousness and public debate.
  - It should also inform the debate by communicating relevant knowledge and information to the general public.
  - For example, the costs of failing to undertake unpopular but necessary parametric reforms such as raising the retirement age should be clearly spelled out in an accessible way.
  - To cite another example, to foster greater participation in pension systems, the government should educate the general public about the risks of myopia and the benefits of saving for retirement.

# 5 Way forward: Asia-wide reforms

- **Set up an independent National Social Security Council (NSSC)**

- An independent National Social Security Council 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. A consultative process will reflect, balance and reconcile stakeholder interests.
- Related to this, NSSC would improve coordination between different ministries which have some responsibility for pensions, and promote better private-public partnership. Such a body would take a long-term view which more closely aligns pension commitments with available resources.
- It could also push through consistent and harmonized 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.
- There is also a need for an independent Board and pension regulator. In terms of personnel, NSSC and the two bodies require a balanced set of skills and experience, along with a proven track record of serving

# 5 Way forward: Asia-wide reforms

- **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 such as the aforementioned NSSC 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

# 5 Way forward: Asia-wide reforms

- **Promote equity and sustainability**
  - It is clear from the country chapters that there is a lot of disparity between the various segments of the population 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. In some cases, privileged pensions and health care for the two groups pose a major risk to fiscal sustainability.
  - Gradual, rational 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 reform, 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 not only future workers but future retirees as well.
  - A high-priority reform area in all countries is to raise the retirement age, which has become obsolete in light of fast-rising longevity. In some cases, the contribution rate will have to be raised substantially.

# 5 Way forward: Asia-wide reforms

- **Achieve adequate retirement income**

- In many countries, large segments of the population are excluded from the pension system. This means that expanding coverage is a first step for securing adequate retirement income for the widest possible segment of the population. China's efforts to set up a rural pension system is a good example of such efforts. 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.
- At a broader level, ensuring an adequate retirement income dictates that individuals assume greater responsibility for their own retirement needs. In practice, this is likely to involve supplementing a national defined benefit scheme for basic needs with a defined contribution scheme based on individual earnings. Some specific additional measures for boosting 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.
- In practice, the conversion of lump sum into annuities and other regular payments, and the more general challenge of phasing

# 5 Way forward: Asia-wide reforms

- **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

# 5 Way forward: Asia-wide reforms

- **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. While there is a great deal of variation in the returns performance of developing Asia's pension systems, the country chapters suggest that overall there is significant scope for improvement.
- However, 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 – including greater investment in equities – to raise returns. 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.

# 6 Final observations

- **Pension reform must be part of policy package**
  - Although our book focused sharply on developing Asia's pension systems and pension reform, it is unrealistic and unproductive to ignore the overall socio-economic context and overall policy environment in the pension reform process.
  - For example, the underdeveloped financial markets of many of the region's countries constrain the ability of the pension system's investment managers to improve the returns of their investments and conversion of lump sum benefits into annuities. Therefore, enhancing returns via portfolio diversification and annuitization is more relevant for more developed countries with sound and efficient financial systems. Put differently, policies which promote financial development are complementary to pension system reforms aimed at improving returns and annitization.
  - Likewise, successfully raising the retirement age requires flexible labor markets which can productively deploy large numbers of older workers. Fiscal reforms, to provide incentives for retirement savings and to safeguard pension assets, and health care reform, to deliver affordable health care for the old are also

# 6 Final observations

- **At the same time, pension reform can also reinforce and speed up reform in other areas.**
  - For example, portability of pensions contributes to greater mobility of workers and hence a more flexible labor market. Therefore, increasing the portability of pensions can complement other labor market reforms such as greater flexibility in the terms and conditions of labor contracts.
  - To cite another example, fully funded schemes can contribute to bigger, deeper and liquid financial markets. Therefore, introducing such schemes can complement financial market reforms such as strengthening the legal and regulatory framework to promote good corporate governance.
  - Pension reform can also serve as a catalyst for health care reform since both old-age income and health care are vital components of the well-being of the retirees. A comprehensive policy package for the elderly should seek to provide adequate income as well as affordable health care.
  - The need to protect the purchasing power of pension benefits can contribute to macroeconomic stability by highlighting the

# 6 Final observations

- **East Asian countries have traditionally prioritized growth over adequate, widely accessible and robust social protection systems, including pension systems.**
  - However, the sheer speed and scale of Asia's demographic changes, and the serious shortcomings of current pension systems, means that putting off pension reform is no longer an option.
  - For Asia's growing army of elderly, pension systems could deliver a number of major benefits – including consumption smoothing over lifetime, insurance against longevity risk, and poverty relief.
  - However, these benefits have to be traded off against labor market efficiency and, most critically, overall economic growth. The challenge for the region is thus to achieve adequate old-age income support without jeopardizing

# 6 Final observations

- **Building up a good pension system entails large opportunity costs, including less resources available for health, education, infrastructure and, more generally, meeting the needs of the non-elderly population.**
  - Exactly how a society allocates the large costs and risks associated with old-age income support depends on its collective preferences, especially the relative weight of social risk pooling vis-à-vis individual risk taking.
  - Regardless of the allocation, this book has laid out a number of concrete and specific guiding principles for moving forward on the biggest structural challenge looming on the region's horizon, that of coping with exceptionally rapid population aging.
  - Finally, somewhat ironically, the fact that some countries currently have only rudimentary pension systems can be beneficial. This allows those countries to learn from the

## 7 Pensions sector, Asia's financial sector development and ADB

- One of Asian Development Bank's core strategic priorities is financial sector development.
  - Asia's financial systems continue to lag its more dynamic real economies
  - In particular, banks still dominate Asia's financial and the region's non-banking sectors remain relatively underdeveloped
- ADB's Financial Sector Operational Plan (FSOP) articulates five broad financial sector agendas [see p.53 in Role of ADB]
  - One agenda is "Supporting the development of contractual savings sector, including the reform of social security systems, to widen the institutional investor base and generate long-term finances and risk capital"
  - Pension reform in particular can play a big role in