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## APPENDIX H: MANAGEMENT RESPONSE

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Public and private pension systems are an essential mechanism in client countries for reducing the risks of old-age poverty and smoothing lifetime income so the aged can maintain living standards. Pension systems vary substantially in being sufficiently *adequate* to cover the risks of old-age poverty for most of its population, sufficiently *affordable* so as not to overburden current workers, employers and governments; *sustainable* to be able to provide promised benefits consistent with contribution levels over multiple generations and sufficiently *robust* to withstand the effect of economic, political and demographic shocks. Many are inadequate both in terms of the level of poverty risk reduction provided relative to cost and the level of coverage; many create a substantial financial burden on employers, employees and governments in order to pay for benefits beyond the affordability of the current society; many have had severe problems of financial sustainability creating an obstacle to fiscal stability, economic growth and poverty reduction; and many have proven highly vulnerable to variance in economic and political conditions.

### Bank Support

The World Bank is an acknowledged leader in assisting countries to ensure that their pension systems are adequate, affordable, sustainable and robust. Since 1984, the Bank has helped 68 countries reform their pension systems with support from more than 200 loans and credits. Moreover, the Bank has served as a central source of new thinking on pension reform, having issued over 350 papers and publications, including books such as *Averting the Old Age Crisis* (World Bank 1994) and *Old Age Income Support in the 21st Century* (World Bank 2005), which have proven catalytic in shaping the conceptualization

of pension reform options and strategies. Finally, the Bank has been a leader in setting the stage for debate and for knowledge gathering and management in its organization of international, national, and regional conferences and seminars on pension reform issues; multiple formal and informal training programs for policy makers and practitioners; creation and dissemination of a common computer model for systematically projecting and evaluating pension reform options; and by creating communication linkages through its Web site, international, and regional networks.

### The OED Review

Management welcomes this timely and comprehensive review of Bank assistance to pension reform and the development of pension systems. This Management Response discusses the OED report's main findings and presents views on key issues that are fundamental to the success of the Bank's work in this important area. It is important to keep in mind that most structural reforms undertaken in Bank client countries occurred in the late 1990s, while judgments over outcomes, sustainability, adequacy, affordability, and robustness can only be made after a period of 10 or more years. Conclusions regarding the Bank's assistance should therefore be viewed as tentative.

### Main OED Findings and Recommendations

#### OED Findings

The OED reports principal findings are:

- *Focus on fiscal sustainability.* The Bank's focus on pension reform has often been sparked by concerns about fiscal sustainabil-

ity. While addressing funding gaps, too often the Bank has not sufficiently addressed the primary goal of a pension system to reduce poverty and provide adequate retirement income *within a fiscal constraint*. Moreover, it has also focused insufficient attention on the income of the aged.

- *Emphasis on increasing savings and capital markets development.* The Bank has emphasized the pro-growth aspects of multi-pillar reform—increased savings and capital market development but the OED evaluation found few countries in which these promised outcomes have been achieved.
- *Gaps in support to reform programs.* Some of the multi-pillar reforms supported by the Bank have shortcomings indicating the need for continued follow-up to the initial reform. For example, the Bank’s activities in Latin America and the Caribbean tended to be limited to funded reforms, even when pensions covered a small percentage of the population. While Bank assistance was instrumental in instituting parametric pay as you go reforms, the Bank did not press for additional first-pillar reforms required by many Latin America and Caribbean countries.
- *Support for multi-pillar reforms where inadequate preconditions existed.* The Bank persistently encouraged some countries to institute multi-pillar reforms even when financial-sector conditions were weak. Furthermore the Bank failed to try to dissuade countries with little control of corruption from actively developing multi-pillar reforms. The Bank did not persuade multi-pillar reformers to develop diversified pension portfolios or support countries building the capacity to monitor the fiscal stability of their reforms. Last but not least, the Bank’s performance in improving contribution collection in some countries was ineffective.
- *Economic and sector work.* While it is unclear how prior economic and sector work led to adequate policies, the general focus of Bank ESW has influenced the issues considered in Bank operations. While the overall approach to support multi-pillar reform has been clear, ESW has been lacking on some specific

issues. Research and policy analysis often has been incomplete, spotty, and sporadic.

- *Capacity building.* In many instances the Bank did not include sufficient capacity building in its initial agenda or in later follow-up activities on pension reform. In some cases, technical assistance has been successfully tied to adjustment operations—but not always.
- *Internal and external cooperation.* Internal coordination has not been consistent or sufficient in many areas, including advice on the income of the aged and financial sector assessment (FSAP included). Externally, the World Bank has limited its dialogue to clients or government departments that shared the Bank’s views on pension reform. Coordination with other donors and agencies has not always been smooth.

## OED Recommendations

The OED Review’s recommendations are discussed below, along with management comments.

## MANAGEMENT COMMENTS

### *On the Analysis and Conclusions*

Management finds the study comprehensive in analyzing support for pension reforms and agrees with the general thrust of most of the recommendations. In particular, management agrees with the recommendations to strengthen internal coordination and the diagnostic framework for determining country readiness for privately-managed second pillar reforms.

***A Dynamic Learning Framework.*** In management’s view, the report could do more to portray the dynamic character of the learning process which has characterized the Bank’s framework for pension reforms over the 20 years covered. Working at a country level and internationally, the Bank has contributed to knowledge products and, in the process, learned and reevaluated its position and formal and informal guidance to staff. This dynamic character has influenced the development of research programs for the areas where key uncertainties exist at a conceptual, empirical and implementation level. The report acknowledges the Bank’s knowledge products as a foundation for policy dialogue but does not evaluate knowledge

products as an essential element of the country dialogue. These include central policy-focused analytical products (such as the pension primer series), capacity building efforts (including global pension core courses, regional training programs, Bank-sponsored conferences and seminars), and policy research programs (such as on annuities, coverage and old-age poverty). This learning process has led to revisions of the Bank's perspective on pension reform over time, including a much firmer view on objectives of pension systems and reforms, and the substance and process criteria the Bank applies for supporting country pension reform proposals. A more systematic review of the Bank's knowledge products would have provided a richer view of the whole range of instruments used in helping countries reach their desired development objectives.

**Benchmark Criteria Applied.** Management would have preferred that the review apply what it views as benchmark evaluation criteria appropriate to specific time periods of Bank interventions. The report applies the 2001 document *Social Protection Sector Strategy: From Safety Net to Springboard* ("Strategy") (World Bank 2001a) as a benchmark against which the Bank's activities from 1984 to 2004 are assessed. However, much of the Bank's support for pension reform measures predates this document. Moreover, there was a substantial growth of learning in the Bank and in the international community as to good practice approaches. Indeed, the report acknowledges that the "most intense" period of Bank activity was from 1998 to 2001, before "Strategy" was published. Much of the Bank's work during that period was influenced by the findings of *Averting the Old Age Crisis* (World Bank 1994), which, although not a formal strategy document, serves as a stronger benchmark to measure the Bank's activities in the 1990s, prior to the publication of "Strategy." There are significant points of difference between "Averting" and "Strategy" largely arising from the experience the Bank gained through its involvement with countries that underwent parametric and structural reforms. Management believes that using "Strategy" as the benchmark to assess activities that were guided by "Averting" leads the OED Report to a

more critical set of findings and conclusions than would have been the case if more time-appropriate benchmarks were used. Finally, the report acknowledges the Bank guidance document *Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform* (World Bank 2005) but does not link recent interventions to the new approaches suggested in this document reflecting four years additional experience, consultation, research and reflection.

**The Impact of the Bank.** In management's view, the report appears to overstate the role and potential impact of Bank support, relative to the influence of country reform agendas and the agenda of other development partners. Much of Bank lending took place after reforms were legislated and where countries required fiscal assistance. In Latin America for example, of the 12 countries that undertook structural reforms, the Bank was active in only seven. Of these, the Bank provided support against the backdrop of country initiatives often heavily influenced by the Chilean experience, with the Bank becoming involved only once the broad reform model had been decided.

**Fiscal Necessity for Pension Reform for Growth and Poverty Alleviation.** Management puts a greater weight than the review on the importance of fiscal crises and the priority this demanded as part of a poverty-alleviation and growth strategy. The threat to economic stability and growth posed by pension systems in Latin America in the 1990s arose from design characteristics and mismanagement that posed unsustainable fiscal and economic burdens and which often benefited middle and upper income groups at the expense of the poor. Poorer households in Latin America often bore the brunt of these circumstances in inflation taxes or forgone economic growth or fiscal resources for more properly targeted poverty alleviation support. In Europe and Central Asia, many of the existing pension entitlements could not be sustained in an environment of substantial economic retrenchment. Many of the aged poor in Europe and Central Asia suffered from effective benefit reductions. Gov-

ernment requests for Bank assistance in reforming pension systems and the form this assistance took emanated from such circumstances. In most cases, the Bank was approached by clients faced with crisis situations, and staff reacted with assistance often focused on stopping fiscal hemorrhaging of earnings-related public pension systems. Only once hard-won economic stability was achieved by the late 1990s could a more sober dialogue be established about fiscally-sustainable ways of addressing more broadly the risks to income in old age (including coverage), particularly the risk of poverty. In management's view, these changing client needs and Bank responses could have come out more clearly in the OED review.

**Minimum Coverage, Benefits and Poverty Alleviation.** In management's view, the review should have taken a broader view of the links between pension reform and poverty reduction. The review for the most part focuses narrowly on the links between pension reform and the elderly poor. There are other essential dimensions of the role of pension reform in alleviating poverty. The report questions whether the Bank's assistance in pension reform focused sufficiently on supporting the elderly poor, including extending coverage and ensuring minimum benefit entitlements. Two essential concepts are not discussed. It is because relatively high income earners often have had substantial claims on GDP via their acquired pension rights that pension reform is and was urgently needed. Expenditures of such large sums of resources on relatively few individuals compared to total population raises questions of resource allocation, equity, fairness and growth. Reducing the fiscal burden required for existing and future pension entitlements attributed to only a portion of workers and retirees is an essential means of freeing up precious fiscal resources for old-age poverty alleviation. Although pension reform may initially only affect a few people, it can have strong and relevant ripple effects throughout the economy. This was part of the rationale for intervention in the pensions sector in the late 1990s, and management would have liked a larger discussion of this rationale in the review.

### **Strategy Evolution and Differentiation since 2001.**

The Bank has differentiated its strategy according to country characteristics, based on assessments of prospective vulnerability of the elderly population in relation to other vulnerable groups as reflected in the 2001 Strategy. Moreover, it has weighed the fiscal resources and institutional capacity necessary to provide additional support for vulnerable populations. Attention to coverage has increased substantially in Latin America and the Caribbean, where there is a potential to reduce vulnerability of the aged while managing fiscal costs. In Europe and Central Asia, where coverage has been higher than in other regions, increasing attention is being paid to coverage in the face of weaknesses in some countries in benefit provision; and in South Asia and Africa, expansion of coverage is being considered against the pressing needs of all vulnerable groups as well as fiscal and institutional resource constraints. The focus on vulnerability is an essential metric of the 2001 Strategy that does not come out in the OED review.

**Country Cases.** In some cases, application of narrow technical criteria leads to differences between OED and management on interpretations of results.<sup>1</sup>

### **On the Recommendations**

**Recommendation 1.** Develop Guidelines to Design Pension Reforms and Pay Greater Attention to Parametric Reforms: (a) Pay greater attention to parametric reforms to ensure fiscal sustainability and to the macroeconomic, financial, and institutional sector preconditions necessary for a multi-pillar reform. This would involve preparing and implementing guidelines to ensure well-tailored assistance to country conditions and consistent policy prescriptions including statistical indicators and in-depth assessments; and (b) Be more realistic in presenting the benefits of the secondary objectives of pension reform in dialogue with client countries, as there is insufficient empirical evidence to support the claims that funded systems have or can improve savings and capital market development.

**Parametric Reforms.** Management will continue to focus attention on reform options to ensure the affordability and adequacy of benefits, as well as system and fiscal sustainability and robustness in the face of shocks. The Bank's will continue to evaluate pension systems against country objectives and then to recommend reforms measures (including parametric and/or structural reforms) appropriate to country conditions. Management notes that the current framework used for evaluating pension reform options already evaluates both parametric and structural reforms. Recently, the Bank co-sponsored with the Swedish social security administration a key review of a promising unfunded pension reform option—Non-financial or Notional Defined Contribution (NDC) plans (World Bank forthcoming).

**A Diagnostic Framework for Second Pillar Reforms.** Management fully agrees with the importance of guiding criteria for establishing privately-managed second pillar reforms and will establish a working group represented by HDN, FSE and PREM to develop a diagnostic framework. The recently initiated series of FSAP Updates and demand-driven ESW are enabling the Bank to identify the actions needed to improve the performance of young second pillars, as well as the actions that new reformers need to consider before establishing second pillars. The results of this work will be supplemented by the development of relevant indicators for a larger number of reforming countries in order to produce a meaningful set of guidelines. Attempting to standardize such criteria in checklists would likely restrict the ability of staff to tailor advice on reforms to the wide variation of country conditions.

**Impact on Savings and Capital Markets.** Although the empirical evidence linking pension policies and economic growth are widely debated, strong theoretical arguments and a growing body of empirical evidence point to a link between pension reforms and strengthening the efficiency and transparency of the financial sector. There are also well documented strong empirical links between financial sector development and eco-

nomical growth. To the degree that pension policy reform has a medium-term impact on growth, whether through structural reforms or parametric reforms to existing systems, such growth will be the strongest and most efficient measure to reduce poverty, including poverty of the aged. Management agrees with the importance of realistically presenting the benefits of the secondary objectives of savings growth and capital market development. Measures to support these objectives must be fully consistent with a hierarchy of measures supporting a strategy towards poverty alleviation.

**Recommendation 2.** Build Client Capacity: Develop a checklist for client capacity requirements (including contribution collection, contributor database development, actuarial and policy analysis, regulation of multi-pillar operations) to assess client requirements and determine how best they can be met. This would involve ensuring that a plan for technical assistance is put in place for reform initiatives so that client capacity is developed.

Development of institutions is an essential part of most pension reforms and assessing capacity-building requirements are key to the development of a successful reform. Management now addresses overall issues of capacity building in the context of results-based CASs, according to the priorities set out in country-owned plans such as PRSs. Capacity, along with governance and country results frameworks, are standard subjects covered during management review of draft CASs. Capacity-building plans are prepared by clients with support from the Bank and other development partners. To the extent that the Bank is financing technical assistance for such capacity building, management will continue to require that plans are put in place consistent with project implementation needs. Management would not see a checklist as necessarily effective, given the need to adapt Bank support to country conditions. Moreover, the Bank can only review capacity-building technical assistance programs to the degree that it is requested to do so by country authorities.

**Recommendation 3.** Conduct Research on Outstanding Issues: Ensure that adequate analysis is conducted on key issues such as income of the aged, the impact of corruption and governance on the feasibility of effective pension regulation, methods to foster competition among pension funds, guidelines for investment allocation, the design of non-contributory systems, and ways in which capital markets develop, as well as supportive research that can provide cross-country evidence on these topics.

Management agrees that adequate analytical work is essential to its work supporting the strengthening and reform of pension systems. However, there are many other competing priorities for country analytic work. If CASs identify pension reform as a central element of the Bank's support efforts, management will ask CAS teams to review the knowledge base, including analytic work done by the client country and other development partners, and to address the issue of covering identified gaps. Management considers this the now-current practice and therefore plans no further action on this recommendation. With regard to cross-country analytic and research topics, a task force representing HDN, FSE, PREM, and DEC network and Regional staff will review needs and set priorities for consideration in the work program process of the relevant units. Key issues such as development of improved pension regulation and oversight appropriate to country conditions; alternative design options for unfunded contributory pension schemes; policy options to ensure minimum income support and poverty risk reduction for the elderly including non-contributory schemes; and 2nd pillar fund performance and indicators will be priorities for consideration for further research.

**Recommendation 4.** Improve Internal and External Coordination: (a) Develop a

process to ensure that cross-sector issues are considered including financial issues identified by the FSAP and maintain closer coordination between the Development Economics vice presidency, the Networks, sector units, and country units; and (b) Develop a strategy to play a greater role in consensus building among stakeholders, in particular, international organizations and client agencies.

**Internal Coordination.** Management agrees with the importance of internal and external coordination. In an effort at strengthening internal coordination, the task force outlined above representing HDN, FSE, PREM and DEC network and Regional staff will meet periodically to review inter-sectoral collaboration in the development of central and country-level outputs and strategies and in the context of the analytical and research priorities noted above. The recently initiated FSAP Updates and ESW focused on pensions, insurance and capital markets will play a critical role in this process.

**External Engagements.** The Bank anchors its Country Assistance Strategies in a country's own vision for its development as defined in a Poverty Reduction Strategy or other country-owned process. With this as the framework for country level engagements, staff will continue to actively work with country authorities and coordinate with other development partners. The Bank will stay engaged with other international organizations and bilateral donors and creditors in discussing alternative approaches to pension reform. Management fully agrees to measures to improve coordination and to address differences and commonalities in reform proposals.

**Attachment.** Attached to this Management Response is a table containing detailed responses in the Management Action Record matrix

## Management Action Record

Major monitorable IEG recommendations requiring a response	Management response
<p><b><i>Develop Guidelines to Design Pension Reforms and Pay Greater Attention to Parametric Reforms</i></b></p> <p><i>a. Pay greater attention to parametric reforms to ensure fiscal sustainability and to the macroeconomic, financial, and institutional sector preconditions necessary for a multi-pillar reform. This would involve preparing and implementing guidelines to ensure well-tailored assistance to country conditions and consistent policy prescriptions including statistical indicators and in-depth assessments.</i></p> <p><i>b. Be more realistic in presenting the benefits of the secondary objectives of pension reform in dialogue with client countries, as there is insufficient empirical evidence to support the claims that funded systems have or can improve savings and capital market development.</i></p>	<p>The Bank will continue to evaluate pension systems against country objectives and recommend reforms (including parametric and/or structural reforms) appropriate to country conditions. Management fully agrees with the importance of guiding criteria for establishing privately-managed second pillar reforms and will establish a working group represented by HDN, FSE, PREM and DEC to develop a diagnostic framework. Draft guidelines will be produced within one year, completing Management's commitment with regard to this recommendation.</p> <p>Management agrees with the importance of realistically presenting the benefits of the secondary objectives of savings growth and capital market development. Measures to support these objectives must be fully consistent with a hierarchy of measures supporting a strategy towards poverty alleviation. This issue will be covered under the above guidelines.</p>
<p><b><i>Build Client Capacity</i></b></p> <p><i>c. Develop a checklist for client capacity requirements (including contribution collection, contributor database development, actuarial and policy analysis, regulation of multi-pillar operations) to assess client requirements and determine how best they can be met. This would involve ensuring that a plan for technical assistance is put in place for reform initiatives so that client capacity is developed.</i></p>	<p>Management now addresses overall issues of capacity building in the context of results-based CASs, according to the priorities set out in country-owned plans such as PRSs. Capacity, along with governance and country results frameworks, are standard subjects covered during Management review of draft CASs. Capacity-building plans are prepared by clients with support from the Bank and other development partners. To the extent that the Bank is financing technical assistance for such capacity building, Management will continue to require that plans are put in place consistent with project implementation needs. Management would not see a checklist as necessarily effective, given the need to adapt Bank support to country conditions.</p>
<p><b><i>Conduct Research on Outstanding Issues</i></b></p> <p><i>d. Ensure that adequate analysis is conducted on key issues such as income of the aged, the impact of corruption and governance on the feasibility of effective pension regulation, methods to foster competition among pension funds, guidelines for investment allocation, the design of non-contributory systems, and ways in which capital markets develop, as well as research offering cross-country evidence on these topics.</i></p>	<p>Management agrees that good analytic work is important in supporting the strengthening and reform of pension systems. However, there are many competing demands for limited resources for country analytic work. If CASs identify pension reform as a central element of the Bank's support efforts, Management will ask CAS teams to review the knowledge base, including analytic work done by the client country and other development partners, and to address the issue of covering identified gaps. Management considers this the now-current practice and plans no further action on this recommendation. With regard to cross-country analytic and research topics, the same task force established to strengthen coordination will review needs and</p>

*(Continues on the following page.)*

### Management Action Record *(continued)*

<b>Major monitorable IEG recommendations requiring a response</b>	<b>Management response</b>
	<p>set priorities for consideration in the work program process of the relevant units. With that discussion, Management will consider this action complete.</p>
<p><b><i>Improve Internal and External Coordination</i></b>  <i>e. Develop a process to ensure that cross-sector issues are considered including financial issues identified by the FSAP and maintain closer coordination between the Development Economics vice presidency, the Networks, sector units, and country units.</i>  <i>f. Develop a strategy to play a greater role in consensus building among stakeholder, in particular, other international organizations and client agencies.</i></p>	<p>As noted above, in an effort at strengthening internal coordination, a task force representing HDN, FSE, PREM, and DEC network and regional staff will meet periodically to review inter-sectoral collaboration, notably in the context of the analytical and research priorities noted above.</p> <p>Staff will continue to actively work with country authorities and coordinate with other development partners in the context of a country's own vision for its development as defined in a PRS or other country-owned process. The Bank will stay engaged with other international organizations in discussing alternative approaches to pension reform and to address differences and commonalities in reform proposals.</p>