

# **Sustainability, fairness, and adequacy of pension systems in East and Southeast Asia**

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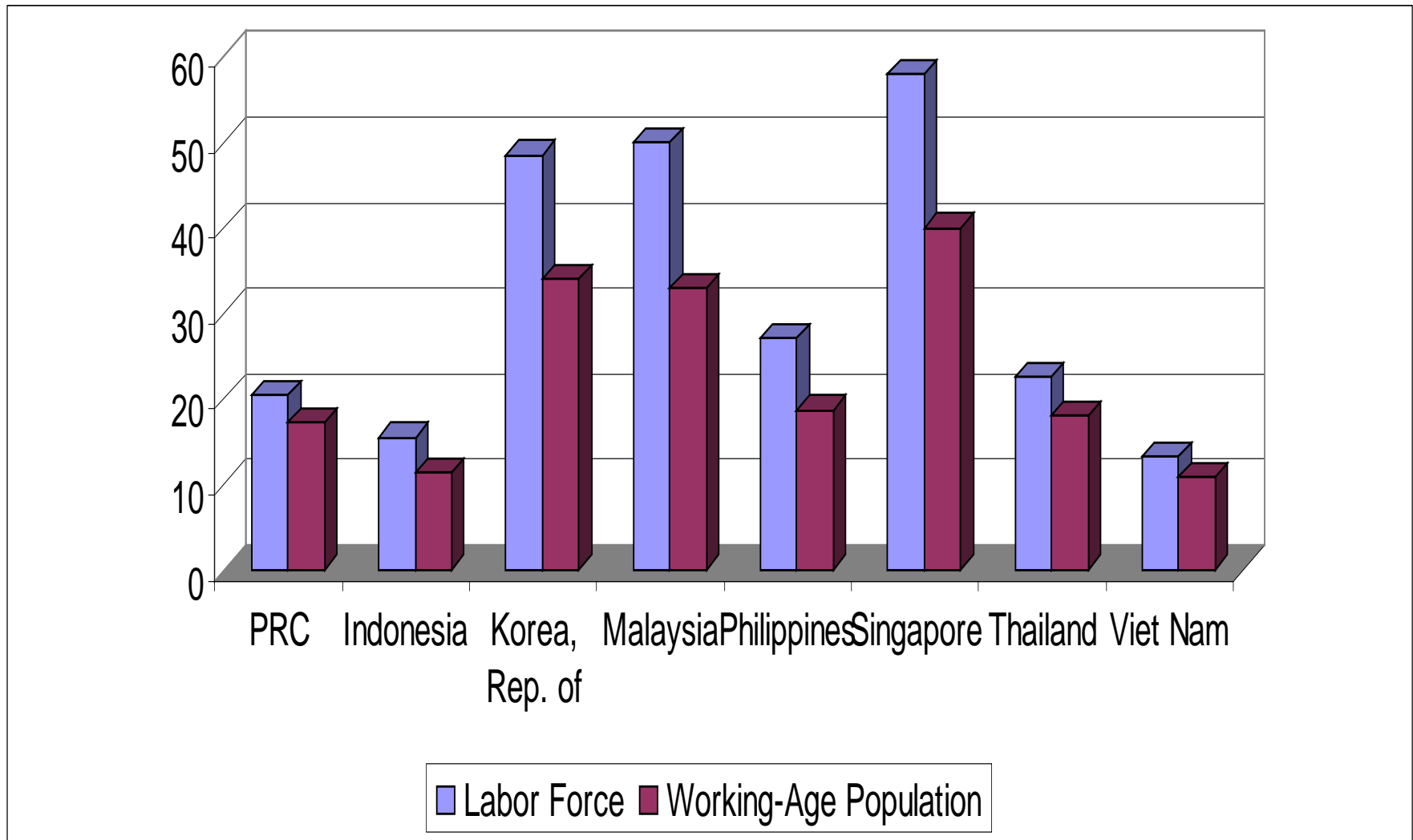
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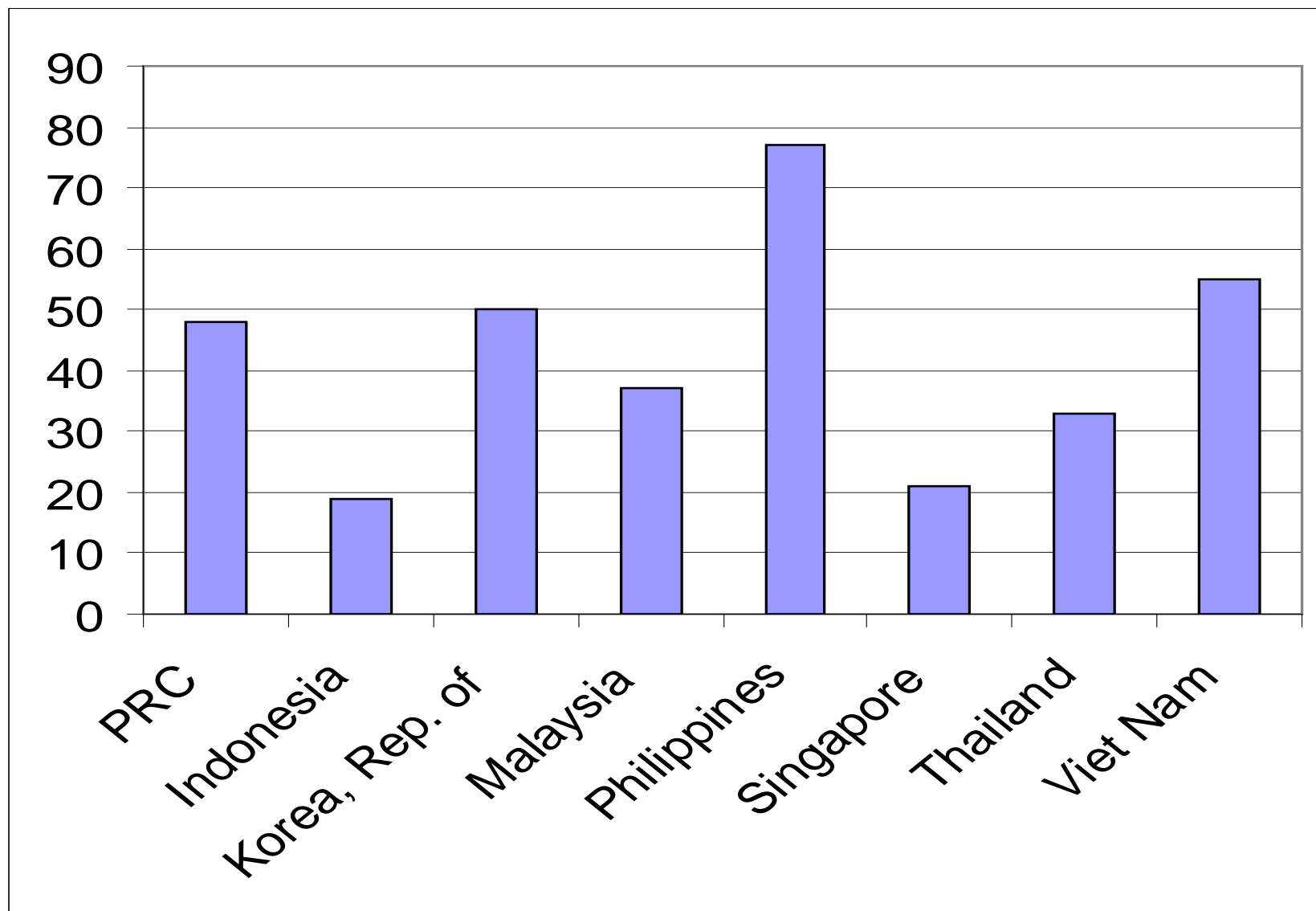
# Introduction

- Asia's region-wide population aging poses two major strategic challenges
  - Sustaining economic growth
  - Providing old-age income support
- An ideal pension system should deliver affordable, adequate, and sustainable old-age economic security
- In Asia, as elsewhere, there is a trade-off between adequacy and sustainability
- Fairness or equity is a key additional priority
- The time to start building strong pension systems is now, even in relatively young Asian countries

# Limited pension coverage

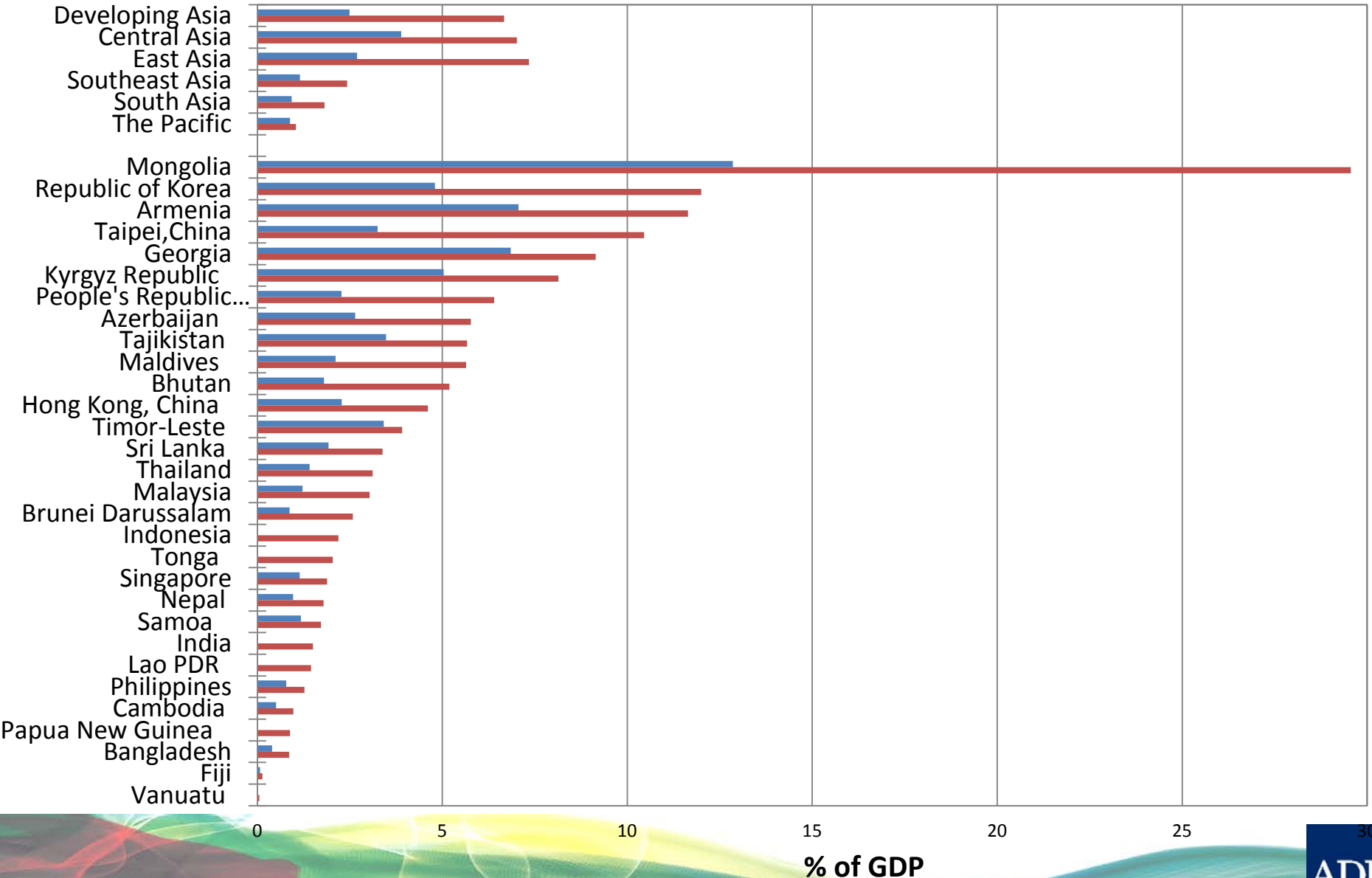


# Inadequate replacement rates

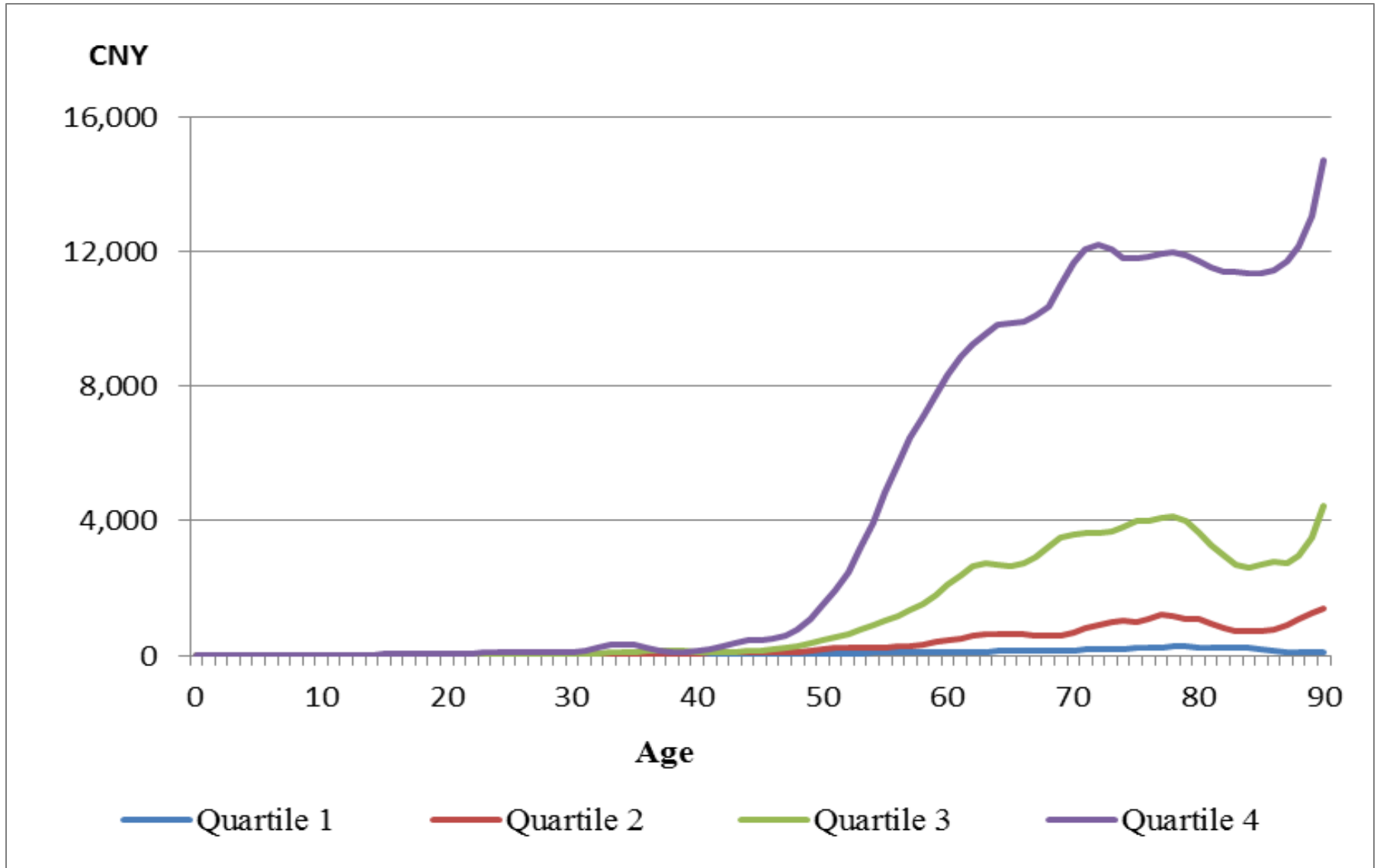


# Sharp increase in projected public pension costs

■ 2010 ■ 2050



# Wide disparities in pension benefits across income groups



# 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

# 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



# 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

# Policy options – Asia-wide

- Improve 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
  - Asian countries must strengthen prudential frameworks to inspire public trust in the management of pension assets
  - 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.
  - 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.

# 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.

# Final observations

- The elderly are a valuable source of labor and human capital
  - All the more so in light of rapid population aging
- Yet they face serious barriers to work
  - Badly outdated retirement age, in light of often dramatic improvements in health, and, more generally, badly outdated employer and societal attitudes toward older workers
- Therefore, pension building and pension reform must be complemented by measures to expand the quantity and quality of elderly employment
  - Good for the elderly and good for the economy at large