Pensions and old-age savings: International experiences

Presentation by

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Multipillar pension system

Pillar	Target groups			Main criteria		
	Lifetime poor	Informal sector	Formal sector	Characteristics	Partici-pation	Funding
0	**X**	X	x	Basic pension	Universal/ residual	Budget
1			**X**	Public managed pension (DB, NDC)	Mandatory	Contributions
2			**X**	Occupational plan funded DB or DC	Mandatory	Financ. assets
3	x	**X**	**X**	Occupational plan funded DB or DC	Voluntary	Financ. assets
4	**X**	**X**	X	Home ownership, health care, …	Voluntary	Assets

(WB, 2005)

Importance: **X** - great; X - moderate; x - little

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Existing situation in Indonesia

Pillar	Target groups		
	Lifetime poor	Informal sector	Formal sector
0 - Basic pension			
1 - Public managed pension			Taspen, Asabri
2 – Mandatory occupational			Jamsostek (?) Severance pay (Labor law 13) (?)
3 – Voluntary occupational			DPPK/DPLK
4 – Informal support	**X**	**X**	X

Indonesia - SJSN law

Pillar	Target groups		
	Lifetime poor	Informal sector	Formal sector
0 - Basic pension	DB, paid by government	DB, fixed rate contribution	DB, based on contributions, % of wage
1 - Public managed pension			
2 – Mandatory occupational	DC	DC	DC (severance pay)
3 – Voluntary occupational			(DPPK/DPLK)
4 – Informal support	X	X	X

Multipillar pension systems – examples

	Malaysia	Singapore	Philippines	Thailand
0 - Basic pension		Means tested		Community saving funds
1 - Public managed pension			SSS, GSIS	OAP
2 – Mandatory occupational	EPF	CPF	Corporate funds	GPF
3 – Voluntary occupational			Private plans	Provident funds
4 – Informal support	**X**	X	**X**	**X**

Importance: **X** - great; X - moderate; x - little

Defined benefit vs defined contribution

- Defined benefit (DB) scheme: **benefit formula**
  - Income related: accrual rate * salary * years of service
  - Flat-rate: fixed amount, sometimes adjusted to the years of work or residence
- Defined contribution (DC) scheme: **fixed contributions**
  - Benefit is dependent upon account balance at retirement

Defined benefit schemes: main concerns

- Fiscal sustainability: ageing and system maturation
  - Dependency ratio: Retirees (60+)/active population (15-59)
  - Implicit pension debt
- Balance between redistribution and actuarial fair pension

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Pension program in SJSN law

- All employees covered, who paid contributions
  - Formal sector: contributions, % of wage
  - Informal sector: fixed rate contribution
  - Lifetime poor: government pays
- Monthly benefit "*to maintain certain standard of living*"
- Options: basic pension or/and earnings-related public benefit

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0 pillar - basic pension

- Basic income support to alleviate poverty
- Financed from general revenue
  - Means-tested benefit
  - Universal flat-rate benefit
- Extend old-age security to all elderly, including informal sector, life time poor
- Ideally, start with small pension at an advanced age

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0 pillar - basic pension Types of interventions

- Means-tested benefit (Hong Kong, India)
  - Allows to target resources, but
  - High administrative cost
  - Susceptible to corruption
  - Mistargeting unavoidable: person vs family
- Universal flat-rate benefit (Nepal)
  - Simple to administer
  - Limited transaction costs, but
  - Fiscal affordability is an issue

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Pillar 1 – earnings-related public benefits

- Income replacement or to prevent old-age poverty (size of benefit)
- Financed by contributions on a compulsory basis
- Option for formal sector, implementation problems for informal sector
- Size to be kept relatively modest to and based on lifetime earnings

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Earnings-related DB pensions: lessons learned

- Old-Age Pension (Thailand)
  - Keep the pension promise real: system started in 1999, first workers eligible for pensions in 2014, by 2027 contributions no longer sufficient
  - Go for gradual implementation: coverage started in 1999 with employers with 20 or more workers, in 2000 expanded to 10 or more, in 2002 expanded to one ore more

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Old age program in SJSN law

- All employees covered, who paid contributions
- Lump sum payable upon reaching pension age
- Portion may be paid after at least 10 years of participation
- ➢ Design problem! No income protection!

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Pillar 2 – mandatory individual saving accounts

- Income replacement and savings
- Financed by contributions on a compulsory basis
  - Publicly managed DC schemes (provident funds)
  - Privately managed DC schemes
- Direct link between contributions and benefits

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Publicly managed DC schemes (provident funds)

- Main problems with centrally managed funds
  - Low rates of return
  - Inefficient allocation of capital
  - High administrative cost, poor-record keeping and disclosure practices and low rates of compliance
  - ➢ Monopolistic control over mandatory contributions

Privately managed DC schemes

	Retail model	Group model	Institutional model
Example	Chile	OECD, Hong Kong	India
Administrative costs	high	Economy of scale	Costs and fees reduced further
Investment portfolio	Multiple portfolios	Selected by employer	Limited portfolio

In sum

- Pension design of different pillars should happen within a national retirement strategy
- Design guidelines
  - 0-pillar and pillar 1 should be modest in size
  - Pillar 2 and 3: investment of funds should be addressed in a professional manner
- Implementation should happen gradually, based on fiscal and administrative capacity of the government

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For More Information

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