

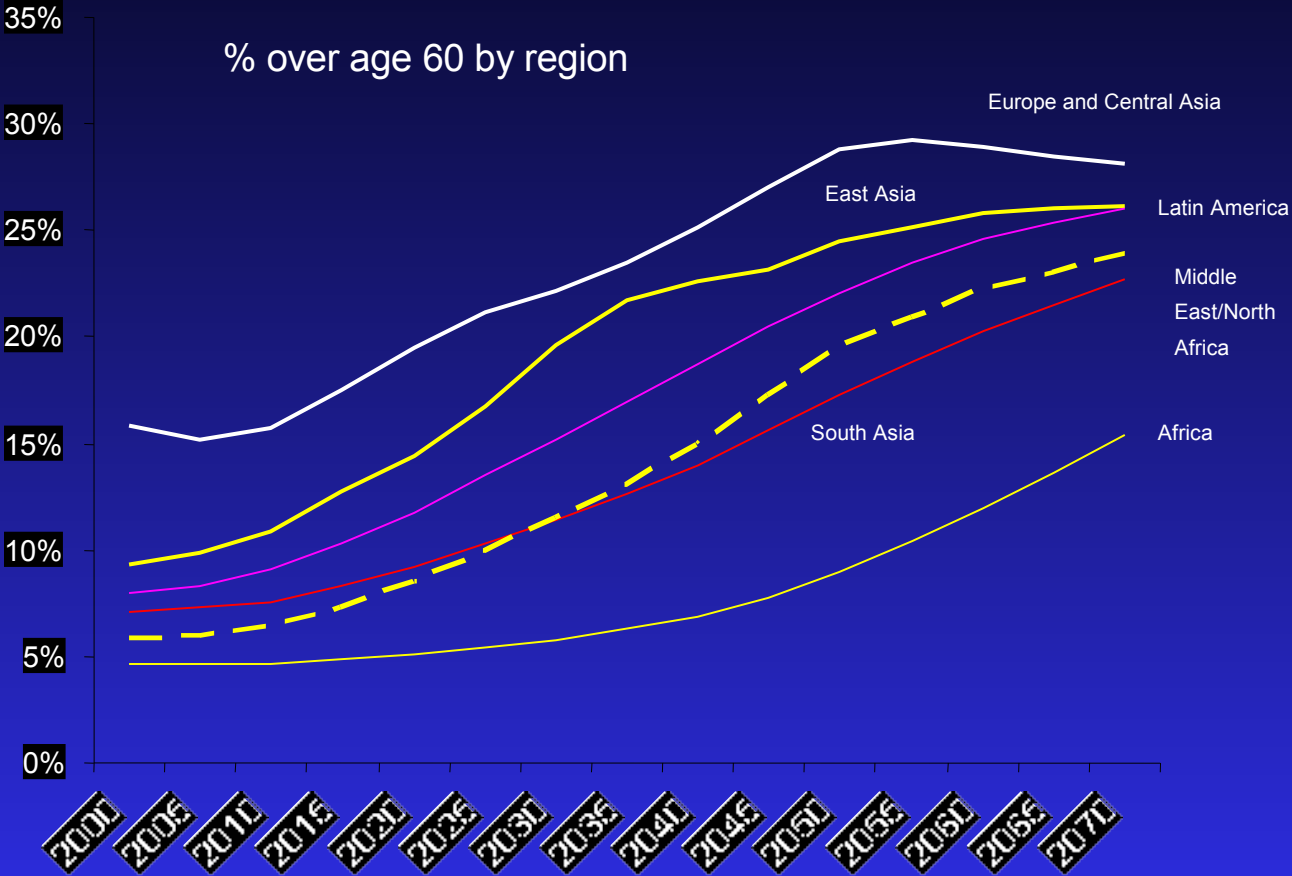
# Global pension reform trends

IIEF Regional Pension Policy Roundtable

Robert Palacios, World Bank

New Delhi, May 1, 2008

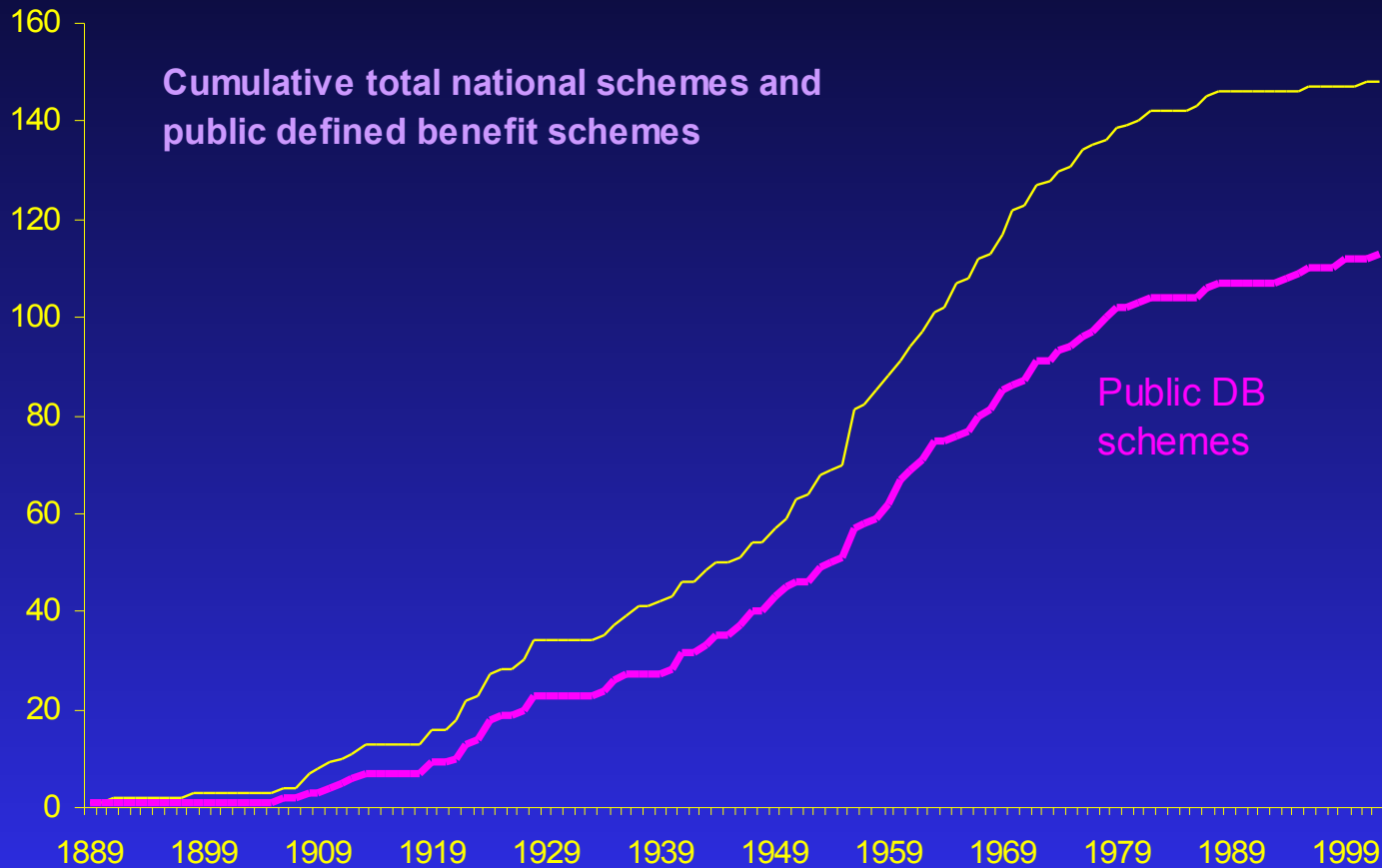
# The world is ageing



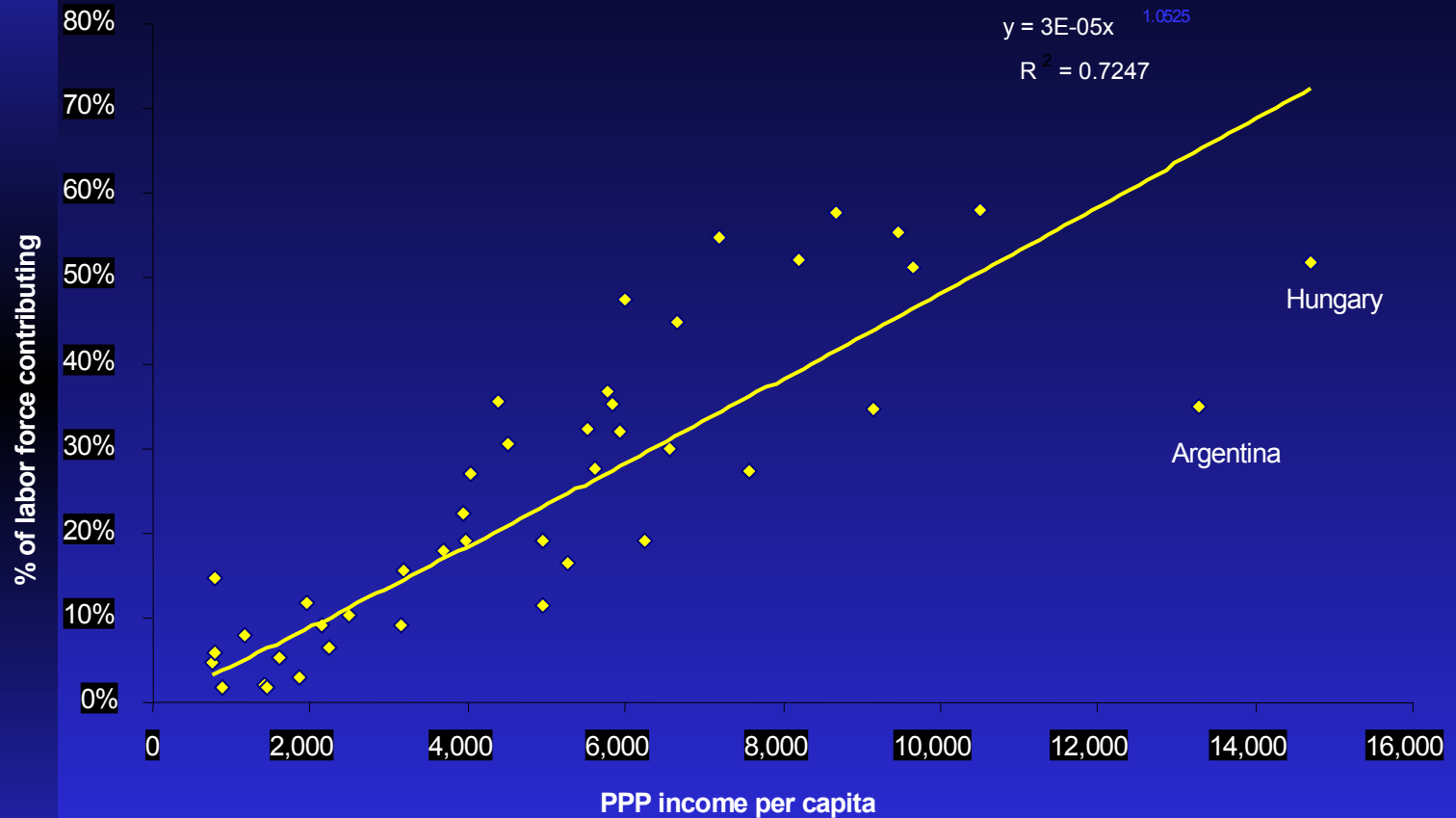
# The two key challenges

- Coverage
- Sustainability

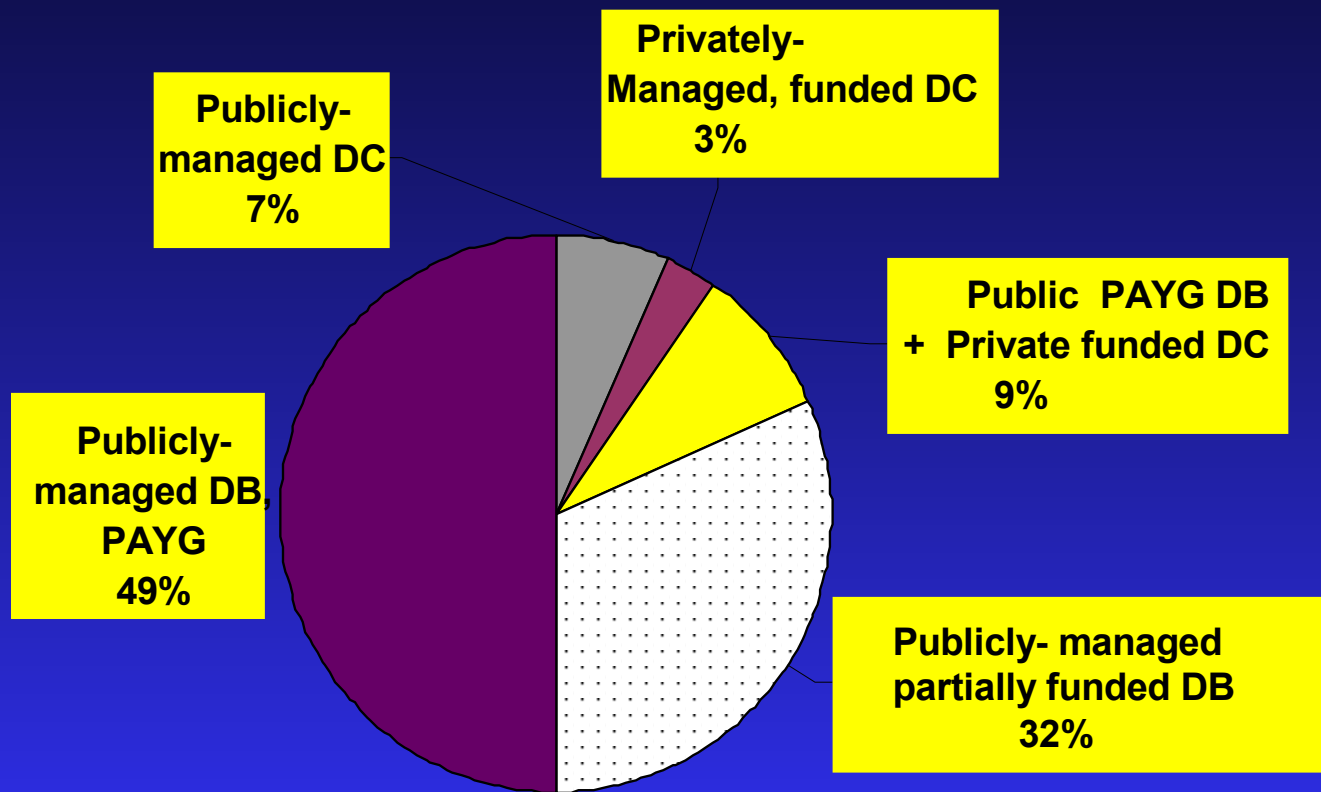
# Most countries mandate pensions



# But coverage varies widely



# Most pensions are unfunded, DB

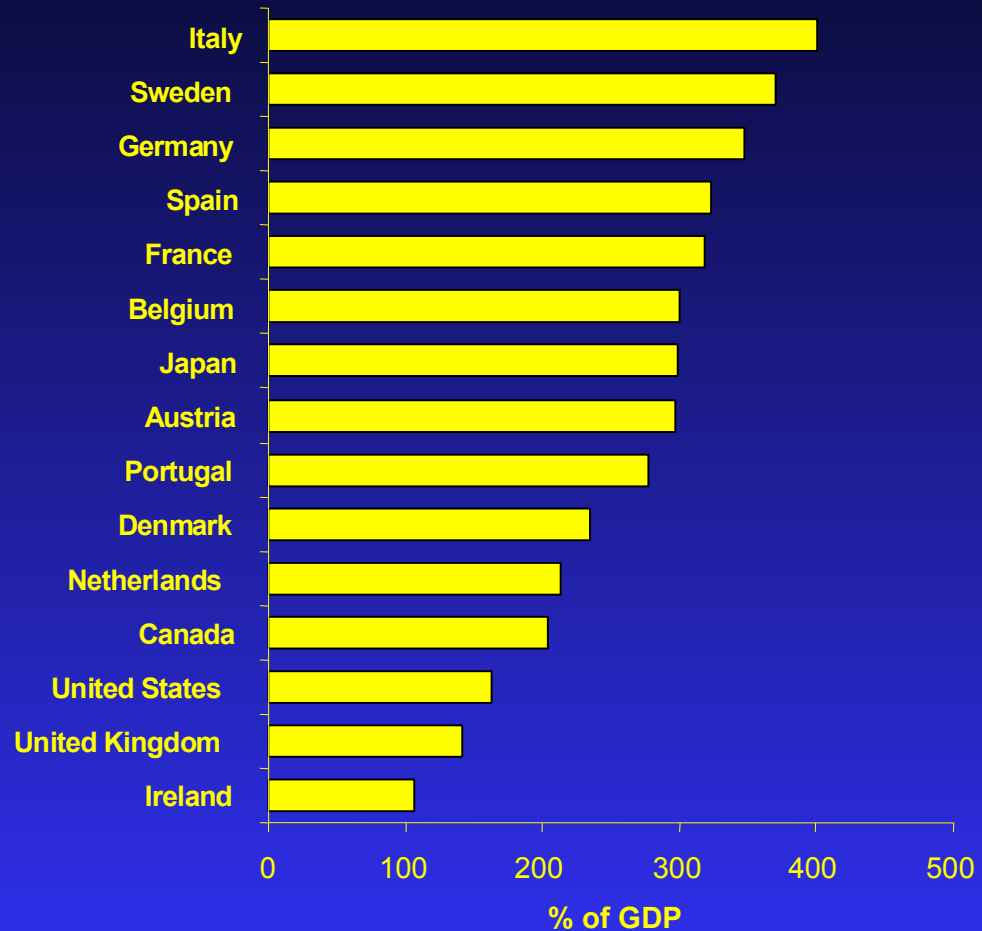


# Resulting in large liabilities

The hidden debt:

Unfunded public pension liabilities  
in the OECD 1990s

Source: OECD (1996)



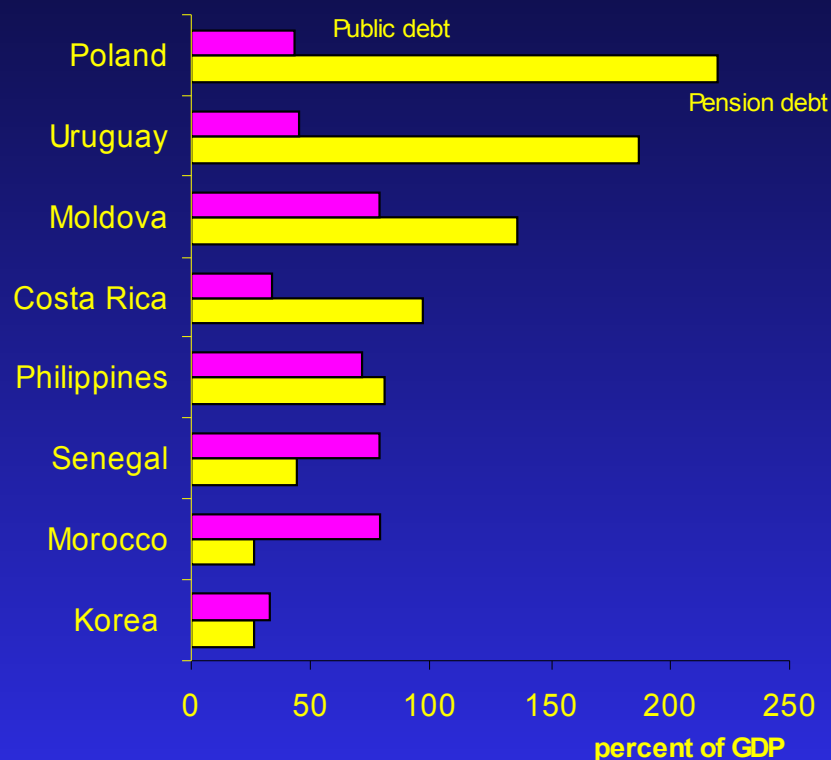
# Resulting in large liabilities

The hidden debt:

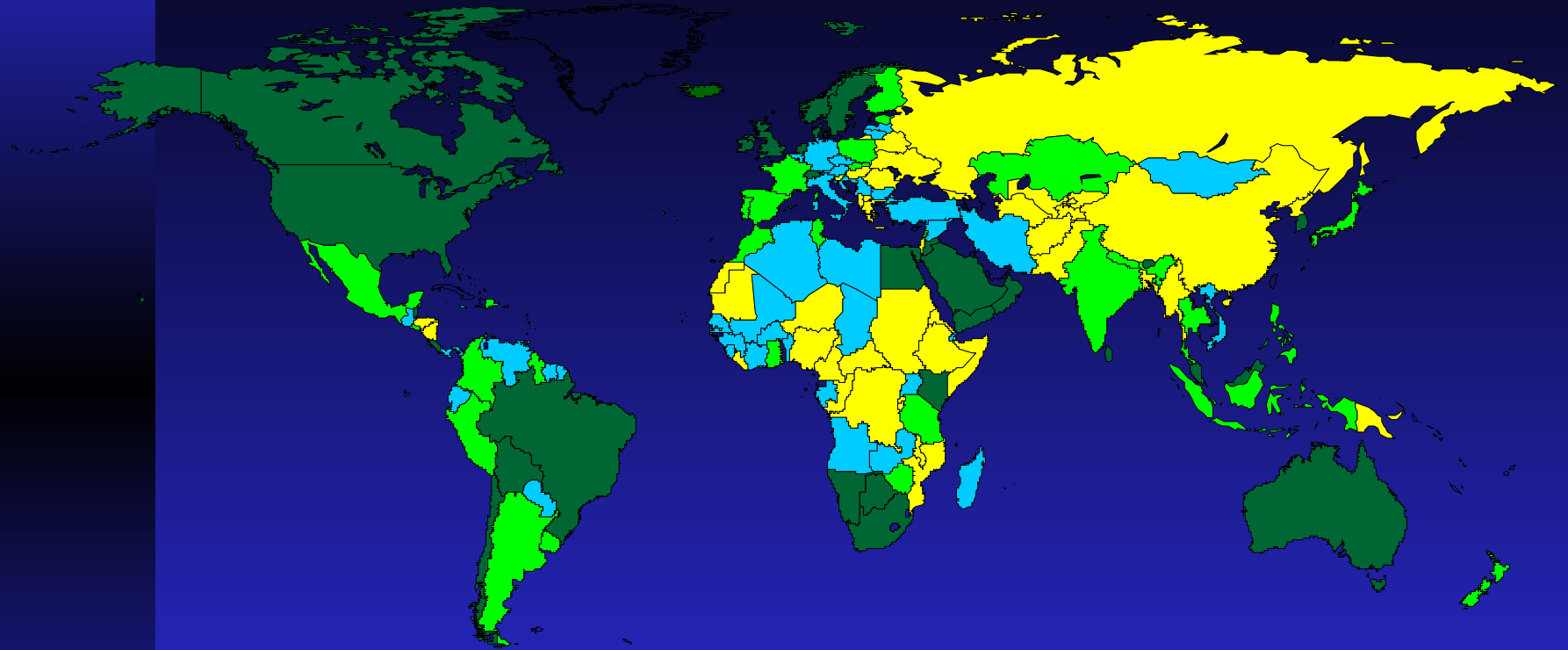
Unfunded public pension liabilities in developing countries

Source:

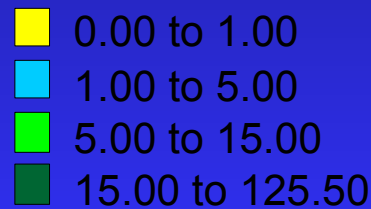
Holzmann, Palacios and Zviniene



# Global Pension Fund Assets *(by share of GDP)*



Pension Reserves as % of GDP



# Civil service pensions in low income countries

- Although coverage is low, liabilities from unfunded civil service pensions are high
- Former British colonies (Anglophone Africa, Caribbean, all of South Asia) inherited similar schemes that are now becoming costly
- Estimated civil service pension debts range are in the range of 25-60 percent of GDP for South Asia
- Recent reforms are trying to prefund liabilities and introduce defined contribution schemes (India (2004), Nepal (2005), Maldives (2008))

What are the solutions?

# Addressing the ‘coverage gap’

- “Coverage gap” has persisted for decades despite attempts to expand formal sector schemes
- Social pensions are increasingly offered as a possible solution, but fiscally burdensome
- Special contributory schemes for informal sector workers are also being introduced in more countries

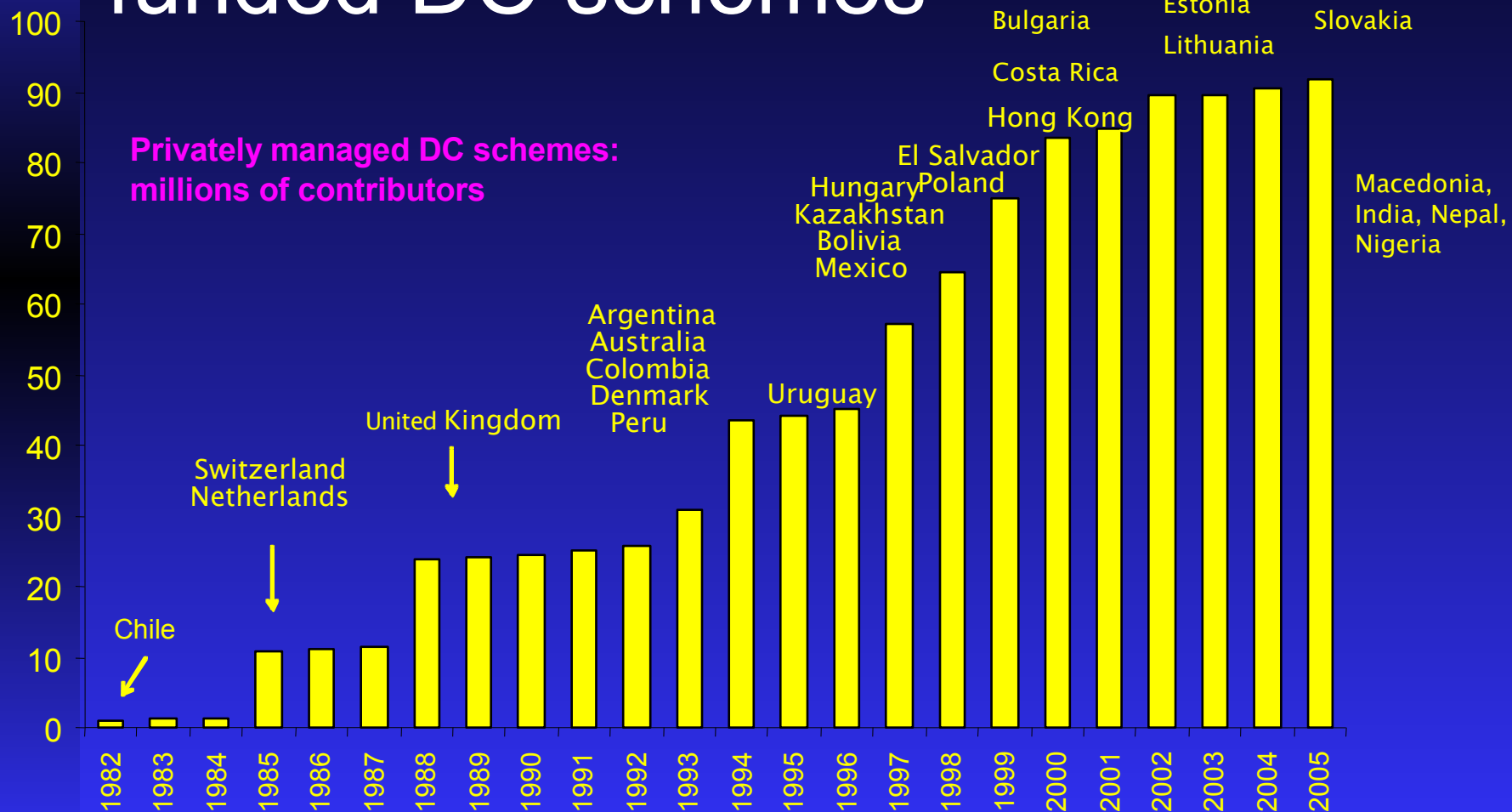
# Addressing the 'coverage gap'

- Traditional DB schemes are not viable for unorganised (informal) sector workers
- Not all workers can be covered immediately – poorest live at subsistence and cannot save
- But unorganised/informal sector is very heterogeneous and many *can* save something
- Transaction costs must be low, contributions flexible and portability easy
- Most promising approach is a flexible DC scheme with matching contributions (instead of traditional tax incentives)

# Making schemes sustainable

- Funding on the increase globally; the debate since 1994 has shifted to (i) how much funding and (ii) who manages
- Three approaches
  - ◆ Reliance on public management
  - ◆ Growth of voluntary private funds
  - ◆ Growth of mandatory private funds
- Different but related challenges for each

# Reform trend is towards private, funded DC schemes



# Making schemes sustainable

- Challenges for public management include:
  - ◆ Depoliticizing governance and investment policy
  - ◆ Aligning interests of governing boards with members, especially in DB context
- Recent approaches include:
  - ◆ Independent boards with commercial mandates models in Canada, Ireland and New Zealand
  - ◆ Applying private pension supervision standards to public funds over time (eg. Costa Rica)
  - ◆ Consensus on minimum standards for public funds regarding disclosure, investment policy, independent audit, valuation of assets etc. (e.g., OECD's *'Guidelines for Pension Fund Asset Management'*, (2005).)

# Making schemes sustainable

- Challenges for private management include:
  - ◆ Setting up capable supervision apparatus and developing new regulatory structure
  - ◆ Dealing with market failures due to consumer ignorance, poor quality of information or uncompetitive practices
- Likely approaches include:
  - ◆ Striking the right balance between flexibility and complexity, choice and cost
  - ◆ A dynamic view toward regulation
  - ◆ More foreign diversification

# Conclusions

- Two key pension policy issues for an ageing world are coverage and sustainability
- Most promising approach for coverage is a subsidized DC scheme for informal sector workers but experience is new and limited
- Increasing funding, especially through conversion from DB to DC schemes is the most important reform trend. But governance and an investment policy free from political pressures is required for success