

Recent Social Security Reforms in Asia

By

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Organization

- Introduction
- Key Drivers of Social Security Reforms
- The NDC (Non-Financial Defined Contribution) Method
- Recent Reforms in Asia-Pacific
- Concluding Remarks

Introduction/1

- This presentation reviews recent social security reforms in Asia-Pacific, with emphasis on countries with major reliance on social insurance schemes.
- Japan, Korea, Philippines, China, Vietnam, and Thailand have accepted social insurance principle as basic framework for social security.

Introduction/2

- In 2004, Indonesia passed comprehensive social security legislation based on social insurance principle. But the legislation is yet to be implemented.
- Except for Vietnam, others have declared their intention to introduce additional pillars (and to substantially expand some of the existing pillars), with a multi-pillar system (Table 1) as an ultimate objective.
- Malaysia and Singapore have not incorporated social insurance principle. They instead rely on a mandatory savings pillar, with the attendant pitfalls.

Table 1: Multi-Pillar Pension Taxonomy of the World Bank

Pillar	Target Groups			Main Criteria		
	Lifetime poor	Informal sector	Formal sector	Characteristics	Participation	Groups
0	X	x	x	“Basic or “Social pension,” at least social assistance, universal or means-tested	Universal or Residual	Budget/general revenues
1			X	Public pension plan, publicly managed, defined-benefit or notional defined-contribution	Mandated	Contributions, perhaps with financial reserves
2			X	Occupational or personal pension plans, funded defined-benefit or funded, defined-contribution	Mandated	Financial assets
3	x	x, X	X	Occupational or personal pension plans, funded defined-benefit or funded, defined contribution	Voluntary	Financial assets
4	x	X	X	Personal or family savings, homeownership, and other individual financial and non-financial assets	Voluntary	Financial assets

Note: The size of x or X characterizes the importance of each pillar for each target group.

Source: Holzmann and Hinz (2005)

Key Drivers of Social Security Reforms/1

- **Short-term Fiscal Pressures** arising from too many recipients and too few contributors, under a fairly rigid design of benefits and contributions.
- **Demographic Trends** (Ageing of the population) (Table 2)
 - These trends have not only lead to pressures on retirement financing needs but also on healthcare expenditure.
 - This suggests that pension and healthcare issues should be considered together. But institutional and organizational, as well as technical considerations has made such joint treatment difficult till now.

Country	Total Population Median Variant (millions)		Average annual rate of change of population		Total Fertility Rate		Median Age		Life Expectancy at Birth		Percentage of total population aged 60 and above		Population aged 60 and above (millions)	
	2005	2050	2005	2050	2005	2050	2005	2050	2005	2050	2006	2050	2006	2050
World	6464.8	9075.9	1.21	0.3	2.6	2.0	28.1	37.8	65.4	75.1	11	22	687.9	1968.1
Asia:														
China	1315.8	1392.3	0.65	-0.3	1.7	1.8	32.6	44.8	71.5	78.7	11	31	147.7	431.5
Malaysia	25.2	43.1	1.80	1.4	2.6	1.8	24.7	39.3	72.2	79.9	7	22	1.8	8.4
India	1103.4	1592.7	1.55	0.3	3.0	1.8	24.3	38.7	63.1	75.9	8	21	89.9	329.6
Indonesia	223.0	285.0	1.30	0.8	2.2	1.8	26.5	40.5	69.6	76.9	8	24	19.0	67.3
Japan	128.1	112.2	0.17	-0.4	1.3	1.8	42.9	52.3	81.9	88.3	27	42	34.7	46.7
Korea	47.8	44.6	0.44	-0.8	1.2	1.7	35.1	53.9	76.8	84.4	11	41	6.7	18.4
Philippines	83.1	127.7	1.84	0.3	3.2	1.8	22.2	37.9	70.2	78.6	6	20	2.5	25.3
Singapore	4.1	5.2	1.60	0.2	1.3	1.8	37.5	52.1	78.6	84.5	13	38	0.5	1.9
Thailand	64.0	75.0	0.70	0.2	1.8	1.8	30.5	42.5	72.0	79.1	11	28	8.9	20.7
Vietnam	84.2	116.6	1.37	0.1	2.3	1.8	24.9	41.3	70.4	78.9	7	26	6.3	29.7
Middle East:														
Bahrain	0.7	1.1	1.70	0.4	2.2	1.8	29.8	40.6	75.1	80.3	5	23	0.03	0.2
Kuwait	2.6	5.2	2.50	0.7	2.2	1.8	29.5	39.7	77.6	82.0	3	24	0.08	1.2
Oman	2.5	4.9	2.18	0.7	3.2	3.0	22.3	35.9	75.0	80.3	4	11	0.1	0.9
Qatar	0.8	1.3	1.90	0.4	2.7	1.8	30.9	40.4	72.7	79.6	3	25	0.002	0.03
Saudi Arabia	24.5	49.4	2.37	0.8	3.5	1.8	21.6	35.1	72.9	79.2	5	16	1.1	8.1
U.A.E	4.4	9.0	2.26	0.9	2.3	1.8	29.0	40.0	79.1	83.7	2	23	0.7	2.1
Selected OECD:														
Germany	82.9	78.8	0.08	-0.1	1.3	1.8	42.1	47.4	78.6	83.7	25	33	20.8	25.5
U.S	298.2	394.9	0.97	0.3	2.0	1.8	36.1	41.1	79.0	83.5	17	26	50.9	104.4
U.K	59.7	67.1	0.34	0.1	1.6	1.8	39.0	42.9	77.9	82.4	21	29	12.8	19.7

Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, *World Population Prospects: The 2004 Revision and World Urbanization Prospects: The 2003 Revision*, <http://esa.un.org/unpp>, 08 January 2007; 5:48:15 PM.

Key Drivers of Social Security Reforms/2

■ Socio-Economic Changes

- Rising female labor force participation
- Changing family structures

(Although these changes are most pronounced in post-industrial countries, they are increasingly evident in the developing world)

■ Globalization

- Globalization has made social safety nets essential for
 - cushioning the burden of restructuring,
 - increasing legitimacy of reforms, and
 - for risk taking by individuals and firms.
- Increasing integration of markets for goods and services, financial assets, factors of production, and knowledge necessitate changes in the way public programs operate, including pensions.

The NDC Method/1

- Following adoption by Sweden, NDC has received considerable attention in the literature (Holzmann and Palmer, 2006).
- The DB and DC classification has been further sub-divided into financial and non-financial components.

The NDC Method/2

- To make existing PAYG system into an NDC system involves competence in managing the following (Börsch-Supan, 2006, p.40):
 1. An accounting mechanism that credits all lifetime earnings
 2. A mechanism linking the final balance with the demographic and macroeconomic environment
 3. An actuarial rule converting the final balance into an annuity.
 4. Claims on future benefits are not collateralized with real capital but promises by a (almost always) government-related entity.

- If pre-conditions of managing these competencies do not exist (or cannot be achieved) the NDC option should not be considered.

The NDC Method/3

Advantages of NDC

- NDC does not involve major transition costs associated with moving from PAYG to FDC (Financial Defined Contribution) system. Some costs may remain.
- Can be more easily made actuarially fair.
- Can more easily limit public pension liability as it is designed to match long-term assets and liabilities at unchanged contribution rate.

The NDC Method/4

Disadvantages of NDC

- Since the financial rate of return is generally expected to be higher than the rate of economic growth (usual actuarial rate conversion option), NDC requires higher level of contribution to achieve the same payout as FDC scheme.
- Less adequate pension benefits to low-wage workers due to the lack of income redistribution;
- NDC schemes lack many of the potential economic benefits associated with funded defined contribution schemes, such as contributing to economic growth.

The NDC Method/5

- NDC makes impact of political decisions affecting pensions more transparent.
- NDC contribution can potentially be regarded less as taxes than in the PAYG system can assist in labor mobility.

Recent Reforms in Asia-Pacific/1

- There has been considerable debate and experience with social security reform but no single idea, system or model has emerged even among the Asian countries.

Recent Reforms in Asia-Pacific/2

JAPAN

- Japan has a comprehensive social security provision covering pensions, health care, unemployment, work injury, and long-term care on a universal basis.

Basic Pension Structure:

- Two-level system – first level is flat-rate universal basic benefit, and second level involving earnings-related benefit only to employees.
- The two level system is PAYG Defined Benefit Program.
- The government subsidizes one-third of total cost of flat-rate basic benefits. There is no subsidy on the earnings-related part.

Recent Reforms in Asia-Pacific/3

- The current replacement rate (including basic benefits) for net income is about 60 percent for a representative male retiree (with an average salary earned during 40 years of coverage) and his dependent wife.
- The average amount of social security pension benefits was around 46 trillion in 2004, equivalent to 9 percent of GDP. This is estimated to rise to 11.6 percent by 2025.
- The health care budgetary costs are expected to rise from 5.2 percent of GDP in 2004 to 8.1 percent in 2025.

Recent Reforms in Asia-Pacific/4

- The aggregate cost of social security (broadly defined to include pension, health, and social security benefits) according to government estimates was 17.2 percent of GDP in 2004, and is expected to increase to about a quarter of the GDP by 2025 if current provisions for benefits remain unchanged.
- It has had to undertake frequent reforms, particularly in areas of pensions and health care.
- These have largely involved parametric changes, such as increased contribution rates, reduced benefits, revised earnings tax, less liberal tax provisions, etc. There are also attempts to enable employers to opt-out of the state scheme providing greater choice as has been done in the UK.
- Raising the retirement age above 65 years has been explicitly not been introduced in spite of strong rationale.

Recent Reforms in Asia-Pacific/5

- In Japan, social security contributions at around 16 percent of GDP exceed the tax revenue.
- This has led to heightened awareness of social security burden by both individuals and businesses.
- Balance sheet deficit in private sector pensions as of March, 2005 was 500 trillion yen (Takayama, 2006).
- This legacy deficit needs to be addressed. Reforms have largely addressed future deficits as difference between future contributions plus budget transfers less liabilities is likely to be only about 50 trillion yen.

Recent Reforms in Asia-Pacific/6

- The elderly today are better-off than 30-44 age group in per capita terms after pension and other benefits are included.
- Takayama (2006) has suggested separating legacy deficit from future operations.
- He has indicated switch to NDC may make the system more sustainable.

Recent Reforms in Asia-Pacific/7

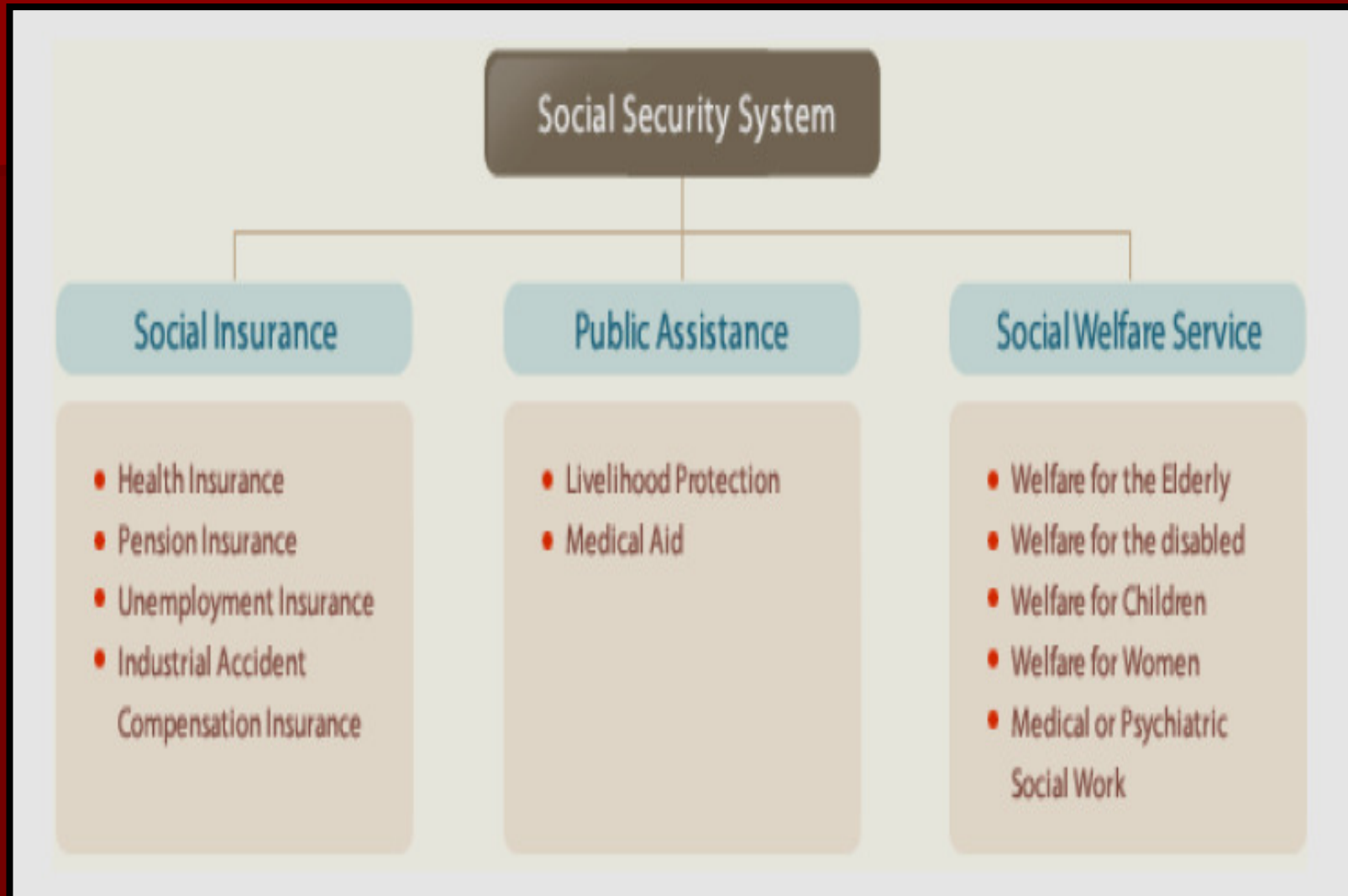
- The legislated increase in contribution rate will not reach peak level till 2017. So slow switch will imply waiting till then.
- Takayama (2006) has suggested earmarking 3 percent consumption tax plus enhanced budget transfers to make much quicker switch to NDC to make pension system more sustainable.
- Consensus on those proposals is yet to develop.
- But Japan is actively searching for solutions even if it implements bold parametric reforms.

Recent Reforms in Asia-Pacific/8

KOREA

- Korea has a comprehensive array of social insurance, public assistance, and social welfare services on universal basis (Figure 1).
- The National Pension Scheme (NPS) was introduced in 1988; the National Health Insurance Program (NHIP) in 1997; and the Unemployment Insurance Program (UIP) in 1995.
- Korea has been undertaking parametric reforms, including increasing retirement age, which will make its NPS sustainable till 2050 (in terms of flows) but its reserves will not be exhausted till after 2070.

Figure 1: Social Insurance Programs for Korea



Source: Oh (2006)

Recent Reforms in Asia-Pacific/9

- Korea is reforming governance structure of its pension funds.
- Korea's current challenges lie in health care financing, including in introducing long-term care.
- Korea is also undertaking major initiatives to raise TFR (which was only 1.08 in 2005).

Recent Reforms in Asia-Pacific/10

THAILAND

- Thailand established social insurance based Old-Age Pension (OAP) system in 1999. It is administered by the Social Security Organization (SSO).
- The first pensions under the OAP will be paid in 2014. However, years of service before 1999 will not be counted.
- The OAP covers (formal) private sector workers. Its membership in 2006 was equivalent to about a quarter of the labor force.
- The OAP system will accumulate substantial reserves. This will reach 16 percent of GDP in 2028 if current contribution rate is maintained. Investing such large pool of funds will pose a challenge.

Recent Reforms in Asia-Pacific/11

- Thailand does have defined-contribution provident fund type arrangement for workers in state enterprises and for those whose employers are listed on the Thai stock exchange.
- Thailand has only a limited zero-pillar, which includes social assistance.
- The civil servants receive a combination of non-contributory defined-benefit and contributory mandatory savings benefits.
- The main reforms in Thailand have focused on addressing under-funding of the OAP (the true cost of the OAP is estimated to be twice the contribution rate of 6 percent); and in replacing the current defined contribution systems with mandated national provident fund arrangement.

Recent Reforms in Asia-Pacific/12

- The policymakers also desire to expand coverage to the agricultural workers and others in the unorganized sector.
- To date however, there has been no concerted efforts to achieve this expansion.
- One of the proposals before the government is to institute universal flat benefit equal to poverty level for all residents; abolish the OAP, and replace it with the National Provident Fund (NPF).
- From the political economy perspective, it is unlikely that this proposal will be implemented.

Recent Reforms in Asia-Pacific/13

- Instead, parametric reforms, such as raising the retirement age, changing the pension-benefit formula, and increasing the contribution rate are more likely, with OAP system maintaining its importance.
- The OAP addresses longevity and inflation risks in a very limited way. These risks and the survivors and disability benefits will need to be addressed.
- In common with many other countries, Thailand lacks overall pension regulator which can ensure professionalism and systemic perspective, while assisting in financial education and overall development of the pensions industry.

Recent Reforms in Asia-Pacific/14

INDONESIA

- Indonesia's comprehensive social insurance legislation of 2004 pays insufficient attention to the long-term sustainability and to performing core functions of social security organization well.

- The core functions (Ross, 2000) are-
 1. Reliable collection of contribution/taxes, and other receipts.
 2. Payment of benefits for each of the schemes in a correct way without any side-payments. In case of pre-retirement loans, ensuring their timely repayment.
 3. Secure financial management and productive investment of provident and pension funds assets.
 4. Maintaining an effective communication network, including development of accurate data and record keeping mechanisms to support collection, payment and financial activities.
 5. Production of timely and policy relevant financial statements and reports.

Recent Reforms in Asia-Pacific/15

- The 2004 legislation plans to dramatically increase coverage from the current 15 percent of the labor force to perhaps 65-75 percent of the labor force.
- The actuarial and other analysis required for such a drastic increase in coverage and for inclusion of most short and long term risks, have not been undertaken. The reversibility principle therefore has not been given sufficient weight.
- It appears that the Indonesian government will consider implementation of 2004 legislation sometime in the first half of 2007.

Recent Reforms in Asia-Pacific/16

VIETNAM

- Vietnam's social security system has relied on social insurance principles, but the coverage has been confined largely to public sector employees.
- Vietnam has also passed a fairly ambitious social security law continuing emphasis on social insurance principle.
- The detailed implementation however is still being awaited.

Recent Reforms in Asia-Pacific/17

PHILIPPINES

- Philippines social security system has traditionally followed the United States.
- The government sector employees are administered by the Government Service Insurance System (GSIS), and the private sector workers administered by the Social Security System (SSS). The combined coverage however does not exceed 30 percent of the labor force.
- The GSIS is adequately funded. The political economy factors however have traditionally hampered matching long-term assets and liabilities of the SSS.

Recent Reforms in Asia-Pacific/18

- The Philippines is attempting to expand the role of pillars 2 and 3. But the progress has been quite limited.
- Philippines also does not have pension regulator.

Concluding Remarks/1

- There is no uniform pattern among the Asian countries concerning social security reform.
- Japan and Korea exhibit high level of competence and commitment to addressing pension and health care (including long-term care) issues.
- As a result, for them NDC type of system merits consideration.

Concluding Remarks/2

- But even these two countries are facing challenges in developing full-fledged multi-tier systems, particularly in developing defined contribution elements.
- Challenges for Indonesia and Vietnam are to develop much greater professionalism and competence before attempting ambitious expansion proposed.
- For Thailand and Philippines, political economy considerations in making their current social insurance-based systems actuarially sustainable; and in introducing mandatory savings tier as part of the social security systems.
- Unless policymakers in Malaysia and Singapore accept the need for multi-pillar system, including the need for social insurance, they are unlikely to be able to address social security issues.

Concluding Remarks/3

- Except for Japan and Korea, there appears to be inadequate understanding in Asia of the need to consider pension and health care financing together to assess future social security burden.
- Civil service pension reform and governance issues have received less than adequate attention from policymakers in Asia.
- Urgent need for rigorous social security research is evident in Asia (except in Japan and South Korea which as OECD members have developed robust research agendas).

Concluding Remarks/4

- As Asian countries attempt to evolve multi-pillar systems, it is essential that pension regulator be established to ensure professionalism, systemic perspective, and provide leadership in enhancing financial education and development of the overall pensions industry.

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Annex 1: Key Provident and Pension Fund Organizations and Indicators in Southeast Asia

Country	Organizations	Contributors as Percent of Labor Force ^a	Contribution Rate (2004)	Wage Ceiling (2004)	Member Balances (USD Billion), Percent of GDP
Malaysia	Employees Provident Fund (EPF)	50.6 (March 2006) ^b	23.0	No	72.2, 52.8 (March 2006)
	Government Pension Fund, Malaysia (GPF)	NA	NA	No	NA
Philippines	Social Security System (SSS)	20-25 ^c (2003)	8.4 (5.07/3.33)	P 15,000 per month	3.3, 3.8 (June 2005)
	Government Service Insurance System (GSIS)	4.5 (2003)	21.0 (12/9)	No wage ceiling	3.7, 4.3 (early 2005)
Singapore	Central Provident Fund (CPF)	58.3 ^d (December 2005)	30.0 ^f	\$4,500 per month from January 2006	74.8, 61.6 (December 2005)
	Government Pension Fund, Singapore (GPF)	NA	NA		NA
Thailand	Social Security Organization (SSO)	21.2 ^e (2003)	6.0	B15,000 month	20.0, 11 (early 2005)
	Government Pension Fund, Thailand (GPF)	3.5(2003)	6.0	Yes	7.8, 4.6 (2005)

a Figures in brackets refer to year to which data refers.

b Includes 4017 foreign workers.

c Membership in the SSS is 23 million but the active contributors are 6-8 million.

d Foreign workers are around 25% of the labor force and are excluded.

e The SSO coverage is overstated as the figure refers to members rather than active contributors. If the provident funds of SOE's are included, the coverage rate may be as high as 25%.

f This rate applies to those below 55 years of age. Lower rates apply to those above 55 years.

Sources: Information obtained for official sources in each country.