



Technical Assistance Report

Project Number: 42326
Research and Development Technical Assistance (RDTA)
October 2009

Developing Asia's Pension Systems: Overview and Reform Directions

ABBREVIATIONS

ADB	–	Asian Development Bank
OECD	–	Organisation for Economic Co-operation and Development
TA	–	technical assistance

TECHNICAL ASSISTANCE CLASSIFICATION

Type	–	Research and development technical assistance (RDTA)
Targeting classification	–	General intervention
Sector (subsector)	–	Finance (insurance and contractual savings)
Themes (subthemes)	–	Economic growth (promoting macroeconomic stability), social development (other vulnerable groups), capacity development (institutional development)
Location impact	–	Regional (high impact), national (high impact)
Partnership	–	Organisation for Economic Co-operation and Development

NOTE

In this report, "\$" refers to US dollars.

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In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

I. INTRODUCTION

1. The Social Protection Strategy, approved in September 2001, is a key approach of the Asian Development Bank (ADB) in the fight against poverty in Asia and the Pacific.¹ This strategy outlines ADB's commitment to developing priority interventions to reduce poverty and vulnerability in the region. A major element of the strategy is social insurance, aimed at mitigating risks associated with unemployment, ill health, disability, work-related injury, and old age. Recognizing the importance of social insurance for old-age income support, ADB has supported several social insurance projects in the past decade to help strengthen pension systems in many developing member countries, including the People's Republic of China, India, Indonesia, Thailand, and Viet Nam. ADB has supported the implementation of new pension schemes with broader coverage and more efficient and sustainable operations. Several technical assistance (TA) projects have also aimed to widen the coverage of pension systems to include the informal sector and low-income groups.² In some cases, support for pension reforms has been explicitly tied to strengthening financial markets, as pension funds can be important sources of long-term financing. Developing Asia's Pension Systems: Overview and Reform Directions (the TA) will build upon the experience in pension systems and reforms of various Asian economies. The TA will produce an organized body of knowledge to inform policy makers and the public on (i) where East and Southeast Asian pension systems are today, (ii) where they need to go, and (iii) what they need to do to get there.³ By creating, organizing, and disseminating policy-relevant knowledge of some Asian pension systems, ADB can assist its developing member countries in learning from each others' experiences and in establishing pension systems that promote the inclusion of a large and growing segment of the population—the elderly—in the development process. The TA framework is in Appendix 1.⁴

II. ISSUES

2. Indeed, the rapid aging of developing Asia's population has highlighted old-age income support. Although demographic transition toward older populations is the most important rationale for pension reform (i.e., building up pension systems capable of delivering affordable, adequate, and sustainable old-age income support), there are other justifications. In particular, the weakening of informal, family-based old-age income support has strengthened the need for effective pension systems. Economic progress in Asia and the Pacific has been accompanied by rapid urbanization and a decline in the agricultural sector. Social and economic changes have given rise to smaller nuclear families, a situation that is not favorable to providing old-age intrafamily support. Evolving social and cultural norms and values, accompanying economic progress, are also contributing to the decline in traditional family-based old-age support.

3. Rapid globalization and labor market developments are other reasons for strengthening developing Asia's pension systems.⁵ While globalization has offered enormous opportunities in terms of access to foreign markets, capital, and technology, it has also led to various forms of structural dislocation and heightened a sense of economic and social insecurity.

¹ ADB. 2003. *Social Protection*. Manila (adopted in 2001).

² These include: ADB. 2004. *Technical Assistance to Viet Nam for Developing the Social Security System*. Manila; ADB. 2003. *Technical Assistance to India for Pension Reforms for the Unorganized Sector*. Manila; ADB. 2007. *Technical Assistance to India for Implementing Pension Reforms*. Manila.

³ The TA concept paper was cleared on 21 August 2008.

⁴ The TA first appeared in the business opportunities section of ADB's website on 15 September 2009.

⁵ For a review of the impact of globalization on East Asian social security systems, see Ramesh, M. 2003. Globalisation and Social Security Expansion in East Asia. In Weiss, L., ed. *States in the Global Economy: Bringing Domestic Institutions Back In*. Cambridge Studies in International Relations. 86. Cambridge: Cambridge University Press.

Well-functioning social protection systems, including pension systems, can ease such insecurity and thereby promote public support for globalization. In Asia, the loss of job security due to globalization is compounded by the presence of a large informal sector. Workers in the informal sector are usually unprotected by labor regulations and lack access to pensions and other benefits.⁶ Asia's growing labor mobility and huge informal employment call for improving pension management and coverage.

4. Pension reform can also stimulate private investment in developing Asia by promoting sound and efficient financial systems. Underdeveloped financial systems are a major weakness in the investment climate of many countries. Indeed, financial development—in particular the development of capital markets—and the consequent improvement of the investment climate are crucial rationales for pension reform. By effectively mobilizing savings and catalyzing the growth of large institutional investors to manage the growing pool of pension assets, well-functioning pension systems contribute to the development of stock and bond markets. In fact, several studies, including those by the World Bank, confirm the positive impact of pension reform on capital market development in developing countries.⁷ Capital market development, in turn, will stimulate investment in Asia and the Pacific by expanding the access of firms to capital. In particular, well-functioning capital markets can facilitate the emergence of new start-up firms, which play a key role in promoting a dynamic and vibrant economy. Studies by the World Bank also found evidence of a positive effect of financial development arising from pension reform on private investment.⁸

5. Successful pension reform should enable pension management institutions to perform five core tasks effectively: (i) reliably collect contributions, taxes, and other receipts, including any loan payments; (ii) pay benefits in a timely and correct manner; (iii) secure financial management and productive investment of pension assets; (iv) maintain an effective communication network, including development of accurate data and record-keeping mechanisms to support collection, payment, and financial activities; and (v) produce financial statements and reports that promote better governance, fiduciary responsibility, transparency, and accountability.

6. In addition, a well-designed pension system should demonstrate certain basic features. Ideally, a pension system should be broad-based, i.e., be adequate in terms of both coverage and range of risks covered; be affordable from individual, business, fiscal, and macroeconomic perspectives; be actuarially and hence financially sound and sustainable over time; be robust to withstand macroeconomic and other shocks; and provide reasonable levels of post-retirement income coupled with a safety net for the elderly poor. Society needs to decide—through policy makers—on the relative weights given to adequacy, affordability, sustainability, robustness, and the level of safety nets, as there may be trade-offs among these features. For example, decreasing benefits helps restore a pension system's long-term financial health but reduces the adequacy of pension income. Likewise, raising contributions promotes sustainability at the

⁶ For an extended discussion of informal workers in Asia, see Felipe, J. and R. Hasan. 2006. Labor Market Outcomes in Asia: An Overview. In Felipe, J. and R. Hasan, eds. *Labor Markets in Asia: Issues and Perspectives*. London: Palgrave Macmillan.

⁷ Studies include Catalan, M., G. Impavido, and A. R. Musalem. 2000. Contractual Savings or Stock Market Development: Which Leads? *Social Protection Discussion Paper Series*. No. 20. Washington, DC: World Bank; Holzman, R. 1997. Pension Reform, Financial Market Development and Economic Growth: Preliminary Evidence from Chile. International Monetary Fund (IMF) Staff Papers. 44 (2). Washington, DC: IMF; Walker, E., and F. Lefort. 2002. Pension Reform and Capital Markets: Are There Any Hard Links? *Social Protection Discussion Paper Series*. No. 201. Washington, DC: World Bank.

⁸ See, for example, Schmidt-Hebbel, K. 1999. *Does Pension Reform Really Spur Productivity, Saving and Growth?* Washington, DC: World Bank.

expense of affordability. Societies must make complex choices regarding such tradeoffs, and this explains why pension reform is a politically difficult process.

7. A major strategic choice confronting developing Asian countries in the context of pension system design is the choice between individual risk bearing and social risk pooling. Under individual risk bearing, an individual bears all the risks, without sharing any risks with others. A good example is defined contribution pension plans, which make the individual responsible for his or her own investment and longevity risks. In contrast, under social risk pooling, society pools together the risks of all individual members and bears the risks on their behalf. In the real world, pension systems typically incorporate elements of both individual risk bearing and social risk pooling but differ with respect to the relative importance of each. In fact, the World Bank's multipillar model recommends combining five different pillars of old-age income support with varying degrees of social risk pooling: (i) pay-as-you-go, defined benefit pension schemes; (ii) mandatory defined contribution; (iii) privately managed, voluntary savings; (iv) zero pillar, providing minimum level of protection; and (v) family support.⁹ The multipillar model has greatly influenced the current thinking on pension design and reform among policy makers around the world. This has led to a consensus that effective old-age income support requires a healthy mix of individual risk bearing and social risk pooling. However, the real challenge for each country is to develop a multipillar system that best suits its own needs, preferences, and capabilities.

8. Identifying the directions for pension reform in Asia requires an understanding of the current shortcomings of its pension systems. A cursory survey of Asian pension systems indicates that there is considerable heterogeneity in terms of key pension parameters such as pension age and contribution rate. Pension reform requires a diagnosis of the main weaknesses of the pension systems. Those weaknesses impede the ability of pension systems to fulfill their basic objectives such as enabling consumption smoothing and relieving poverty. A careful diagnosis is essential to identify what main areas of pension systems need to be strengthened and to lay the groundwork for pension reform.

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

9. The TA will promote improved understanding of the pension systems of East and Southeast Asian countries—the People's Republic of China, Indonesia, the Republic of Korea, Malaysia, Philippines, Singapore, Thailand, and Viet Nam—their main structural features, their main weaknesses, and strategic directions for reform. Asian policy makers and the public will have a better understanding of the current state of their national pension systems, and hence how to improve and strengthen them to contribute to social inclusion and economic development. The TA will also perform an advocacy role of making policy makers and the public more aware of the urgency of pension reform. The TA will facilitate and accelerate dialogue and sharing of knowledge among regional pension authorities.

B. Methodology and Key Activities

10. A comprehensive, in-depth, policy-relevant, and high-quality book about Asian pension systems and pension reform will be published under the TA. The TA will focus on East and

⁹ Holzman, R and R. Hinz. 2005. *Old-Age Income Support in the 21st Century*, Washington, DC: World Bank; World Bank. 1994. *Averting the Old-Age Crisis*. Washington, DC.

Southeast Asia, as economies in these subregions face the fastest demographic aging. The book will cover the following.

- (i) **Overview of pension systems of East and Southeast Asian countries.** This section will discuss common, regionwide challenges and opportunities to highlight the importance of undertaking reforms in pension systems. Such challenges include demographic transition, weakening of informal systems of social support, and globalization.
- (ii) **Country studies of national pension systems.** This section will discuss the latest developments related to pension reforms and policy issues in each country. To facilitate intercountry comparisons, the country studies will follow a standard format—e.g., overview, weaknesses, and reform directions. The studies will also explore the potential impact of pension reform on investment through its impact on financial development.
- (iii) **Pension modeling study.** This section will provide quantitative estimates of the replacement rate—i.e., ratio of retirement income to pre-retirement income—and other performance indicators of pension systems.
- (iv) **Central messages and reform directions for the region.** This section will highlight the most salient lessons—both positive and negative—for the rest of the region. More importantly, it will draw out some specific and concrete directions for reform based on the analysis of the preceding chapters. It will make realistic suggestions on what each country should do to strengthen its pension system. Suggestions can be country-specific to take into account the particular circumstances of each country, and regionwide to take into account common issues.

11. The TA will be implemented in collaboration with the Organisation for Economic Co-operation and Development (OECD), which has expressed support for a joint activity with ADB on Asian pension reform.¹⁰ ADB will be responsible for coordinating the country studies and the overall research program, while OECD will be responsible for the pension modeling study. OECD has developed “Pensions at a Glance” analyses, which can be used to compare expected future pension entitlements and further developed by collecting additional information on other aspects of pension systems. It is envisaged that a common framework of analysis will be used to compare pension systems currently in place in selected Asian countries. An inception workshop will be held to arrive at a common framework of analysis.

12. A regional research workshop on Asian pension systems and pension reform will also be organized to discuss findings from the country studies and pension modeling. Authorities from pension policy-making institutions and other experts on pension systems will be asked to participate in the workshop.

C. Cost and Financing

13. The TA is estimated to cost \$400,000 and will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF—other sources). The detailed cost breakdown and financing plan are in Appendix 2.

¹⁰ Preliminary discussions with OECD were made by Donghyun Park on 25–26 June 2008 at the International Conference on Pension Reform in Asia, organized by the OECD/Korea Policy Centre and the World Bank. Mark Pearson, the Social Policy Division head at OECD, issued an official memo indicating support for an ADB–OECD cooperation on Asian pension reform.

D. Implementation Arrangements

14. ADB will be the Executing Agency, responsible for implementing and monitoring the TA. In particular, the Macroeconomics and Finance Research Division will implement the TA in collaboration with departments concerned. Since the TA will be implemented in partnership with OECD, the letter of intent between ADB and OECD will serve as the basis of their partnership.¹¹

15. For the country studies, eight international consultants will be engaged for a total of approximately 7 person-months to write research papers, under the guidance of the TA supervising officer in the Macroeconomics and Finance Research Division. There will be an inception workshop where ADB, OECD, consultants, and resource persons will deliberate on a common framework of analysis. Toward the latter stage, a regional workshop will be organized to present the findings of the research papers. Resource persons will be hired for approximately 1.5 person-months to review the papers, provide comments, and serve as discussants in the workshop. Two national consultants will be engaged for a total of 3 person-months to assist in preparing the country studies and organizing the regional workshop and related activities. Once all the chapters of the book are completed, an international copy editor and desktop publishing specialist will be hired for about 2.5 person-months to ensure a high-quality publication that adheres to ADB style, usage, and format.

16. All consultants will be engaged individually in accordance with ADB's *Guidelines on the Use of Consultants* (2007, as amended from time to time). Terms of reference for consultants are in Appendix 3. A draft outline of the final report is in Appendix 4. Disbursements under the TA will be made in accordance with the ADB *Technical Assistance Disbursement Handbook*.¹² The TA is expected to be completed in 24 months, from September 2009 to August 2011.

IV. THE PRESIDENT'S DECISION

17. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$400,000 on a grant basis for Developing Asia's Pension Systems: Overview and Reform Directions, and hereby reports this action to the Board.

¹¹ On 2 March 2005, ADB and OECD signed a letter of intent identifying the areas of cooperation, one of which is in financial markets, including pensions and insurance.

¹² ADB. 2008. *Technical Assistance Disbursement Handbook*. Manila.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p>Impact</p> <p>Governments in East and Southeast Asian countries implement initiatives toward pension reform at the national and regional levels.</p>	<p>Policy initiated on pension reform</p>	<p>Government papers</p> <p>Reports and press releases on pension reform initiatives</p>	<p>Assumptions</p> <p>Governments are willing to share information and data about their pension systems and to undertake reforms if their pension systems are diagnosed as requiring urgent reforms.</p> <p>Risks</p> <p>Governments fail to recognize the urgency of reforms.</p> <p>Implementation of policy reforms is delayed.</p>
<p>Outcome</p> <p>Relevant pension reform lessons and examples of current good practices provided to governments and the public</p> <p>Improved understanding of the pension systems of East and Southeast Asian countries (e.g., their main structural features, their main weaknesses, and strategic directions for reform)</p>	<p>Consultation dialogues held with both public and private sectors on pension systems and reforms</p> <p>A book published on pension reform and current good practices, which is disseminated in East and Southeast Asian developing economies</p>	<p>Feedback from governments and private sector organizations</p>	<p>Assumptions</p> <p>There is wide interest on the issue of pension reforms from governments and the public.</p> <p>Adequate consultations are held with critical stakeholders from pension policy-making institutions.</p> <p>Information and data for the research studies are available.</p> <p>Risks</p> <p>Authorities in pension policy-making institutions resist change and new policies.</p>
<p>Outputs</p> <p>1. Terms of reference for researchers and/or consultants drafted</p> <p>2. Inception workshop held</p> <p>3. Regional research workshop on Asian pension systems and pension reform</p>	<p>Workshop attended by pension authorities and experts</p> <p>Papers completed and presented during the workshop</p>	<p>Number of participants and quality of discussion in the workshop</p> <p>Generated technical and analytical debate</p>	<p>Assumptions</p> <p>Pension authorities, researchers or experts, and relevant ADB Management and staff are available and interested to participate in the workshop and provide insightful comments.</p>

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p>held</p> <p>4. A comprehensive, in-depth, policy-relevant, and high-quality book published about Asian pension systems and reforms, covering</p> <p>(i) overview of pension systems of East and Southeast Asian countries;</p> <p>(ii) country studies of national pension systems;</p> <p>(iii) pension modeling study, which provides quantitative estimates of the replacement rate; and</p> <p>(iv) central messages and reform directions</p>	<p>Book published, launched, and disseminated</p>	<p>among researchers</p>	<p>Risks</p> <p>Poor attendance in the workshop</p> <p>Lack of data and relevant references to produce quality papers</p> <p>Delays in the submission of papers</p>
<p>Activities with Milestones</p> <p>1. Terms of reference drafted, and researchers and/or consultants engaged to write main papers that will form part of the book.</p> <p>2. Inception workshop provided.</p> <p>3. Regional research workshop, where researchers will present their findings, provided.</p> <p>4.1. Book published.</p> <p>4.2. Book launched.</p>			<p>Inputs</p> <p>ADB:</p> <p>7 person-months of international consultants, 3 person-months of national consultants, 2.5 person-months of international copy editor and desktop publishing specialist, and approximately 1.5 person-months of resource persons, including travel and per diem (\$258,000). Workshops, seminars, and meetings (\$57,000)</p> <p>Miscellaneous administration and support costs, including publications, communications, and office supplies (\$45,000)</p> <p>Contingencies (\$40,000)</p>

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Total Cost
Asian Development Bank Financing^a	
1. Consultants	
a. Remuneration and Per Diem	
i. International Consultants	180.00
ii. Local Consultants	8.00
iii. Resource Persons	20.00
b. International and Local Travel	50.00
2. Workshops, Seminars, and Meetings	57.00
3. Miscellaneous Administration and Support Costs (Including Publications, Communications, and Office Supplies)	45.00
4. Contingencies	40.00
Total	400.00

^a Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF—other sources).
Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. International Consultants for Research Papers (7 person-months, eight consultants)

1. One international consultant will be hired for each of the following country studies: the People's Republic of China, Indonesia, Republic of Korea, Malaysia, Philippines, Singapore, Thailand, and Viet Nam. Each international consultant should be an economist or pension specialist with proven knowledge and extensive work experience on pension systems and reforms. Under the guidance of the technical assistance (TA) supervising unit officer, the consultant will

- (i) provide a brief history of the country's pension system, capturing all key events in the evolution of the national pension schemes;
- (ii) give an overview of the main structural features of the country's national pension schemes, including qualitative description (e.g., defined-benefit, defined-contribution, or a mixture of both) as well as quantitative estimates of pension benefit levels and coverage rate;
- (iii) provide a literature review that summarizes the most important and recent existing studies of the national pension schemes (e.g., studies of fiscal sustainability);
- (iv) highlight the latest developments in national pension schemes in the country, including any significant prospective reforms or ongoing public discussions of such reforms;
- (v) examine the potential impact of pension reform on investment in the country through its impact on the country's financial development;
- (vi) identify functional weaknesses in the pension system that impede the effective performance of core functions such as reliable payment of benefits;
- (vii) identify systemic failures in national pension schemes that compromise adequacy, affordability, robustness, sustainability, and equity;
- (viii) on the basis of (vi) and (vii) above, recommend concrete and specific policies and reforms that will lead to stronger and more efficient national pension schemes; and
- (ix) write a policy-oriented background paper that incorporates (i)–(viii). The background paper will become a chapter in the country-specific studies section of a joint Asian Development Bank (ADB) and Organisation for Economic Co-operation and Development (OECD) book on Asian pension systems and pension reform.

2. The international consultants will present their papers in a regional workshop to be organized jointly by ADB and OECD, where resource persons will be invited as discussants. The consultants will incorporate the comments from the workshop before submitting their papers to the supervising unit officer.

B. Resource Persons (international, approximately 1.5 person-months)

3. Resource persons, with background as policy makers and/or experts, will be engaged to review the draft chapters and to participate as discussants in the workshop.

C. International Copy Editor and Desktop Publishing Specialist (2.5 person-months)

4. The copy editor will (i) edit the chapters of the book, ensure that they adhere to ADB style and usage, and conform to high publication standards; and (ii) be responsible for

typesetting and proofreading the text, tables, and charts and converting the files into the required format for print publication.

D. National Consultants (3 person-months, two consultants)

5. A national consultant with experience in general economics will be hired for 1.5 person-months to assist in the TA research work. In particular, the consultant will (i) support the preparation of research studies under the TA, (ii) provide technical support to both international consultants and ADB staff in implementing the TA, (iii) undertake quantitative analysis as required, and (iv) perform other tasks as may be assigned by ADB staff.

6. Another national consultant will be hired for 1.5 person-months to serve as coordinator of the regional workshop. The consultant must have experience in organizing workshops and will be responsible for the preparation of administrative requirements and implementation of logistical arrangements for the workshop and related activities.

DRAFT OUTLINE OF THE FINAL REPORT

A. Introduction

1. The rapid aging of developing Asia's population has highlighted old-age income support. Demographic transition is by far the most important—but not the only—rationale for pension reform (i.e., building up pension systems capable of delivering affordable, adequate, and sustainable old-age income support). This section will also discuss common regionwide challenges and opportunities to emphasize the urgency of pension reform in developing Asia. This study will provide readers with an up-to-date overview and diagnosis of various Asian pension systems, and give policy makers concrete and specific policy advice for pension reform.

B. Country Studies: East Asia and Southeast Asia

2. This section consists of eight country chapters—the People's Republic of China, Indonesia, Republic of Korea, Malaysia, Philippines, Singapore, Thailand, and Viet Nam. The study concentrates on East and Southeast Asia, which are more advanced in population aging. Each chapter will be based on a background paper prepared by a pension specialist with expert knowledge of that country's pension system. The country chapters will follow a standard format, which will revolve around an overview, diagnosis of key weaknesses, and country-specific policy recommendations. The country chapters will include a section that looks at the potential impact of pension reform on investment through its impact on financial development.

C. Pension Modeling Study

3. This section will report and discuss the pension model of the Organisation for Economic Co-operation and Development, and the results from simulating that model for countries in Asia and the Pacific. The simulations will input the parameters of each country's pension system (e.g., contribution rate and retirement age) as well as socioeconomic parameters (e.g., average gross domestic product growth rate and demographic structure) into the model to estimate several performance indicators. Of particular interest is the replacement rate, or the ratio of pension benefits to pre-retirement income, which is widely used as a measure of adequacy of pension as a source of post-retirement income. The simulations will be structured to maximize the comparability of the estimates across countries.

D. Central Messages and Reform Directions for the Region

4. This section will start by highlighting the central messages that emerge from the analysis of the preceding chapters. The countries vary widely in terms of their socioeconomic profile and structure of their pension systems, and consequently face country-specific challenges in pension reform. However, many regionwide challenges, such as rapid population aging and inadequate coverage, confront pension systems. This section will also draw out the most salient directions for reform based on the main findings of the book. Finally, this section will touch upon what might be the main relevant lessons that Asian countries can learn from each other as they all strive to deliver affordable, adequate, and sustainable old-age income support to their rapidly aging populations.