Public Sector Pensions
An Overview

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Outline

- Background and stylised facts
- Public sector pensions across the region
- Challenges and paths to reform
Background and stylized facts
Typical structure of national pension (retirement income) schemes:

- **Safety net**
  - Universal or targeted
  - General revenue funded

- **Income replacement**
  - Publicly provided
    - PAYG, partly or fully funded
  - Publicly mandated
    - Privately managed OR Publicly managed

- **Voluntary retirement saving**
  - Employment related (or not), Tax preferred (or not)
Typical structure of national pension (retirement income) schemes: **Australia**

- **Safety net**
  - Universal or **targeted**
  - General revenue funded

- **Income replacement**
  - Publicly provided
    - PAYG, partly or fully funded
  - **Publicly mandated**
    - Privately managed OR Publicly managed

- **Voluntary retirement saving**
  - Employment related (or not), **Tax preferred** (or not)
Typical structure of national pension (retirement income) schemes: **Singapore**

- **Safety net**
  - Universal or targeted
  - General revenue funded

- **Income replacement**
  - Publicly provided
    - PAYG, partly or fully funded
  - **Publicly mandated**
    - Privately managed OR Publicly managed

- **Voluntary retirement saving**
  - Employment related (or not), Tax preferred (or not)
Typical structure of national pension (retirement income) schemes: **New Zealand**

- **Safety net**
  - *Universal* or targeted
  - *General revenue funded*

- **Income replacement**
  - Publicly provided
    - PAYG, partly or fully funded
  - Publicly mandated
    - Privately managed OR Publicly managed

- **Voluntary retirement saving**
  - Employment related (or not), *Tax preferred* (or not)
Typical structure of national pension (retirement income) schemes: **Japan**

- **Safety net**
  - Universal or targeted
  - General revenue funded, contributory

- **Income replacement**
  - Publicly provided
    - PAYG, partly or fully funded
  - Publicly mandated
    - Privately managed OR Publicly managed

- **Voluntary retirement saving**
  - Employment related (or not), Tax preferred (or not)
Public sector pensions are a specific component of the income replacement pillar

- Part of national scheme for all workers OR a different scheme (or multiple schemes) OR the only scheme
- Extent of funding:
  - Funded, Unfunded (PAYG), Book reserved, Partially funded
- Defined Benefits (DB) OR Defined Contributions (DC) OR Hybrid DB/DC
- Publicly provided OR Publicly mandated
Public sector workers often the first covered

Rationale for public sector pensions:

- Increase attractiveness of public sector employment
- Retain public sector workers
- Secure independence of public sector workers
- Shift cost of remunerating public sector workers to the future

BUT, separate schemes often persisted after national schemes established
Key feature of public sector pensions is DIVERSITY

Stylized characteristics - 1:

- Often **separate** from national scheme
- Mostly **DB** with **more generous** benefits, better indexation, often earlier retirement ages than national schemes
- Generally **underfunded** or financed from general revenues on a **PAYG** basis
  - Less than 25% hold reserves
  - Around 25% are non-contributory
Key feature of public sector pensions is DIVERSITY

Stylized characteristics - 2:

- **Potentially large fiscal liabilities**
  - Ageing of public sector workers (often faster than general population)
  - Exacerbated by population ageing-related expenses (health, aged care etc.)

- **Differences in valuation, disclosure and transparency**
  - No internationally standardized method of reporting public sector pension liabilities
Per cent of countries with separate public sector pension schemes

<table>
<thead>
<tr>
<th>Region</th>
<th>%</th>
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<tbody>
<tr>
<td>South Asia</td>
<td>100%</td>
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<tr>
<td>Africa</td>
<td>65%</td>
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<tr>
<td>Middle East/North Africa</td>
<td>61%</td>
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<tr>
<td>East Asia</td>
<td>60%</td>
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<tr>
<td>OECD</td>
<td>52%</td>
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<td>Latin America/Caribbean</td>
<td>44%</td>
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<tr>
<td>Eastern Europe/Central Asia</td>
<td>0%</td>
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Source: Palacios and Whitehouse (2006)
### Institutional arrangements - OECD

<table>
<thead>
<tr>
<th>Fully Integrated</th>
<th>Separate but similar benefits</th>
<th>Fully integrated with top-up</th>
<th>Partially integrated with top-up</th>
<th>Entirely separate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Denmark</td>
<td>Canada</td>
<td>United Kingdom</td>
<td>Germany</td>
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<tr>
<td>Estonia</td>
<td>Finland</td>
<td>Spain</td>
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<td>Austria</td>
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<td>Hungary</td>
<td>Iceland</td>
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<td>Netherlands</td>
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<td>Korea</td>
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<td>Lithuania</td>
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<td>Japan</td>
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<td>Greece</td>
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<td>Slovenia</td>
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<td>Czech R.</td>
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<td></td>
<td>Italia</td>
<td>New Zealand</td>
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Source: Whitehouse (2011)
Funding of public sector pensions vs national schemes

Source: Palacios and Whitehouse (2006)
Typical policy advice for reform of ‘income replacement’ pillar (World Bank, OECD)

- **Full funding** (rather than PAYG) – enhance sustainability, security, capital accumulation
- **Defined contributions** (rather than DB) – to facilitate labour market flexibility
- Contributions to **individual accounts** (rather than social security taxes) – address disincentives to work and save, security
- **Private sector management** – facilitate transparency, address political risk
- Multi pillars for **risk diversification**
Public sector pensions in the region
Diversity in regional arrangements

- Both separate and integrated schemes:
  - Separate: China, India, Korea, Malaysia, Philippines, Thailand
  - Integrated: Australia, Japan, New Zealand, Singapore

- Both DB (PAYG) and DC (fully funded) schemes:
  - DB (PAYG): China, Korea, Malaysia, New Zealand, Philippines, Thailand
  - DC (fully funded): Australia, India, Singapore

- Many reforms underway
Separate schemes - 1

China

- DB, PAYG
- Lifetime indexed pension - age 60 (males), 55 (females)
- No member contributions
- Maximum replacement rate of 90% after 35 years
- No portability to private sector schemes

India

- Reform in 2004 (New Pension System)
- DC, pension funds (previously PAYG DB)
- Contributions: 10% each, member and government
- Managed by professional fund managers in pension funds
- Benefits from age 60, minimum 40% annuitised
- Little private sector coverage
Separate schemes - 2

Indonesia (2004 reform to integrate not implemented)

- DB, PAYG
- Contributions: member 4.75%, government PAYG
- Pension for life from age 56 (or 50 after 20 years service)
- Benefits: maximum replacement rate of 75%
- More generous than private sector schemes

Korea

- Reform in 2009 to improve sustainability
- DB, PAYG
- Contributions: 8.5% each, member and government
- Lifetime pension from age 60, max replacement rate 60%
- More generous than private sector schemes
Separate schemes - 3

Malaysia

- DB, partially funded from Pension Trust Fund
- No member contributions
- Pension for life from age 58 (with at least 10 yrs service) plus lump sum termination payment
- Benefits: maximum replacement rate of 60%
- Private sector employees in Employees Provident Fund (DC, fully funded)
Integrated schemes - 1

Singapore

- Included in the national scheme since 1986 (DC, Central Provident Fund - CPF)
- Pension scheme still operates for pre-1986 public sector employees

Japan

- DB, PAYG
- Flat-rate safety net pensions as for private sector
- Earnings-related pension 20% higher PLUS lump sum benefit
Integrated schemes - 2

Australia

- Public and private sector workers covered by mandatory superannuation guarantee (since 1992)
- Most PAYG DB public schemes closed to new members
- 9% mandatory employer contribution
- DC, fully funded, privately managed superannuation funds
- Benefits from age 60
Challenges and paths to reform
Rationale for reform of public sector pensions

- **Cost:** reduce unfunded liabilities, exacerbated by ageing public sector workforce, GFC and age-related expenditure

- **Integration:** to enhance equity (through harmonization with private sector workers) and efficiency (by facilitating labour market flexibility and less administrative complexity)

- **Lack of transparency, inadequate governance:** security of benefits

- **Design:** often at odds with current policy advice for income replacement pillar (DC, individual accounts, fully funded, private management, good governance, transparency)
Population ageing impacts fiscal sustainability

<table>
<thead>
<tr>
<th></th>
<th>Proportion of population age 60 and over</th>
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<tbody>
<tr>
<td></td>
<td>2010</td>
</tr>
<tr>
<td>Australia</td>
<td>19.5</td>
</tr>
<tr>
<td>China</td>
<td>12.3</td>
</tr>
<tr>
<td>India</td>
<td>7.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>8.9</td>
</tr>
<tr>
<td>Japan</td>
<td>30.5</td>
</tr>
<tr>
<td>Korea</td>
<td>15.6</td>
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<tr>
<td>Malaysia</td>
<td>7.8</td>
</tr>
<tr>
<td>New Zealand</td>
<td>18.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>6.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>16.0</td>
</tr>
<tr>
<td>Thailand</td>
<td>11.5</td>
</tr>
</tbody>
</table>
Reform options for public sector pensions

- **Parametric**: increase pension age, increase service requirement, reduce indexation, reduce accrual factor
- **Integration** with national scheme (scheme for private workers)
- **Pre funding**, reserves, increase contributions
- **Move to DC** from PAYG DB
Reform trends in OECD countries

- **Reducing generosity** of public sector pensions through parametric reforms
  - Finland, France, Germany, Italy, Portugal, Sweden

- **Integration**: transferring to national pension scheme
  - Public pension scheme: Austria, Czech Republic, Greece, Spain, US
  - Mandatory defined contributions in privately managed pension funds: Chile, Denmark, Hungary, Mexico, Poland

- **Pre funding**: establishment of ‘reserve’ funds to pre fund pension liabilities
  - Australia, Belgium, Finland, Ireland, Sweden
Reform trends in region

▪ Parametric:
  ▪ Korea (2009)

▪ Integration

▪ Pre funding

▪ Move from PAYG DB to fully funded DC
  ▪ India (2004), Australia (since late 1980s)
Australia as a case study

- **Integration:** public sector workers covered by mandatory superannuation guarantee
- **DB schemes closed** to new employees (except military and judges): unfunded liabilities 15% GDP
- **Pre funding:** Future Fund established in 2006 to finance future retirement income liabilities of public sector workers
- **Transparency:** unfunded liabilities included in government financial statements using comparable valuation methods
- **Governance:** public and private sector superannuation funds subject to common regulations
- **Performance:** public sector superannuation funds comparable to other not-for-profits, better than retail funds
Challenges facing public sector pensions include:

- **Population ageing** and ability to finance future liabilities of unfunded or partially funded schemes
- **Economy-wide inequity and efficiency** due to lack of integration with national (private sector) schemes OR no private sector schemes
- Poor governance and performance of funded schemes due to **inadequate regulation and/or transparency**
THANKYOU