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**
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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

South Asia	100%
Africa	65%
Middle East/North Africa	61%
East Asia	60%
OECD	52%
Latin America/Caribbean	44%
Eastern Europe/Central Asia	0%

Source: Palacios and Whitehouse (2006)

Institutional arrangements - OECD

Fully Integrated

- Australia
- Estonia
- Hungary
- Latvia
- Lithuania
- Slovak R.
- Slovenia
- Czech R.
- Poland

Separate but similar benefits

- Denmark
- Finland
- Iceland
- Netherlands
- Sweden

Fully integrated with top-up

- Canada
- Spain
- United States
- Ireland
- Japan
- Norway
- Switzerland

- Italy
- New Zealand

Partially integrated with top-up

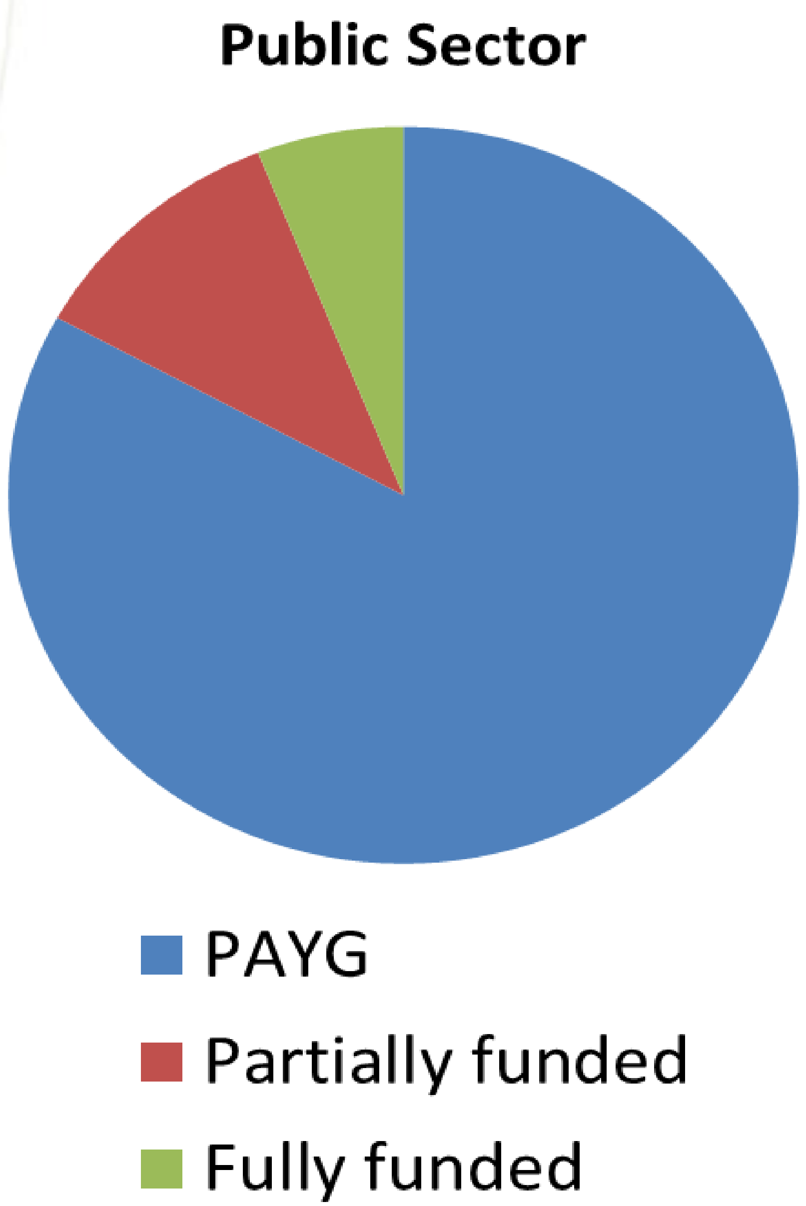
- United Kingdom

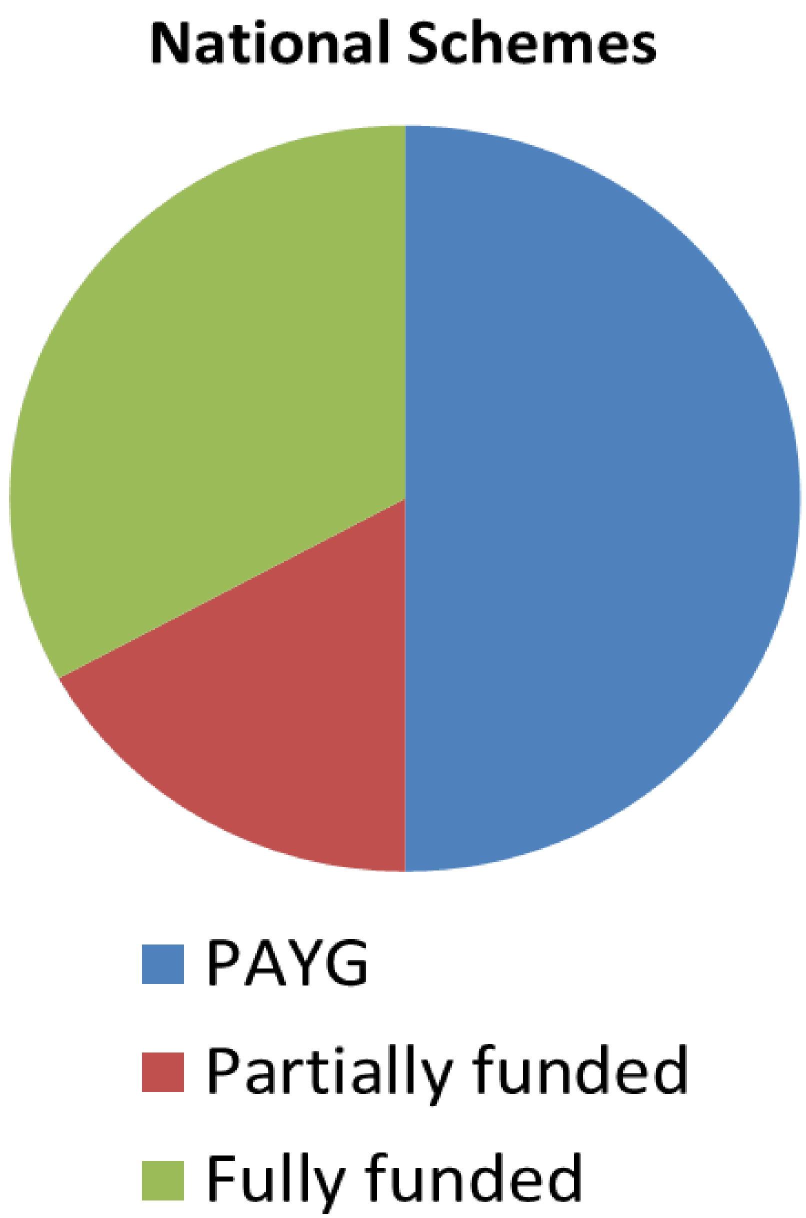
Entirely separate

- Germany
- Austria
- Belgium
- Korea
- France
- Greece
- Luxembourg
- Portugal
- Turkey

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

	Proportion of population age 60 and over	
	2010	**2030**
Australia	19.5	26.5
China	12.3	23.4
India	7.5	12.4
Indonesia	8.9	16.0
Japan	30.5	37.9
Korea	15.6	31.1
Malaysia	7.8	15.0
New Zealand	18.2	26.3
Philippines	6.7	11.3
Singapore	16.0	35.6
Thailand	11.5	21.6

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
  - Singapore (1986), Indonesia (2004 policy, not yet implemented), Australia (1987, 1992)
- Pre funding
  - Malaysia (1991, Pension Trust Fund), Australia (2007)
- 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

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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**

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