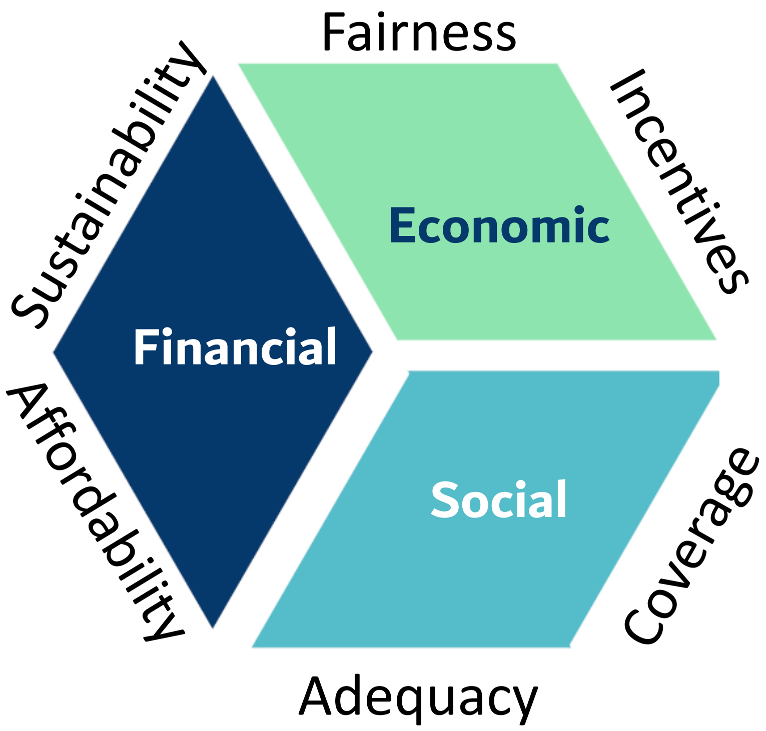
Reforming Pensions in the Pre and Post COVID-19 world

Gustavo Demarco
Pensions Global Lead
The World Bank

October 2020

Pension systems pre 2020: objectives and challenges

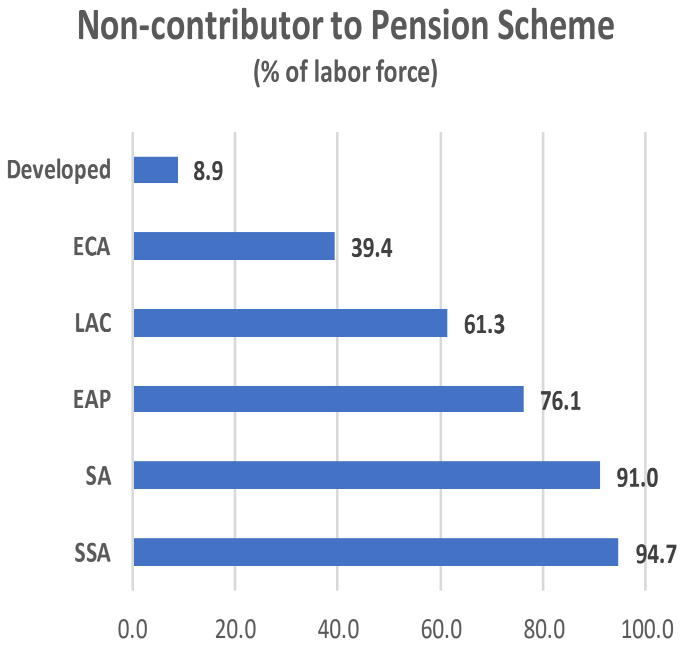
Objectives

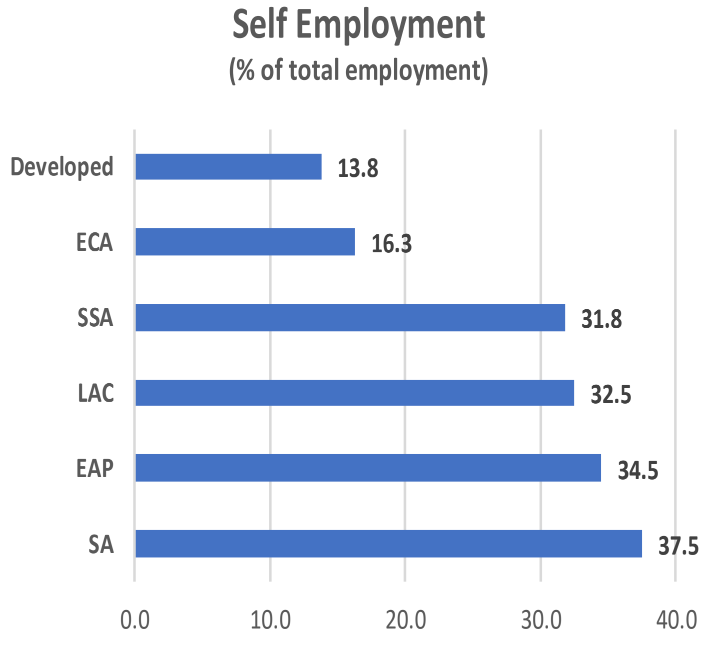


Key Challenges in developing countries

- Low coverage
- Unsustainable
- Regressive

The coverage challenge: informality and exclusion

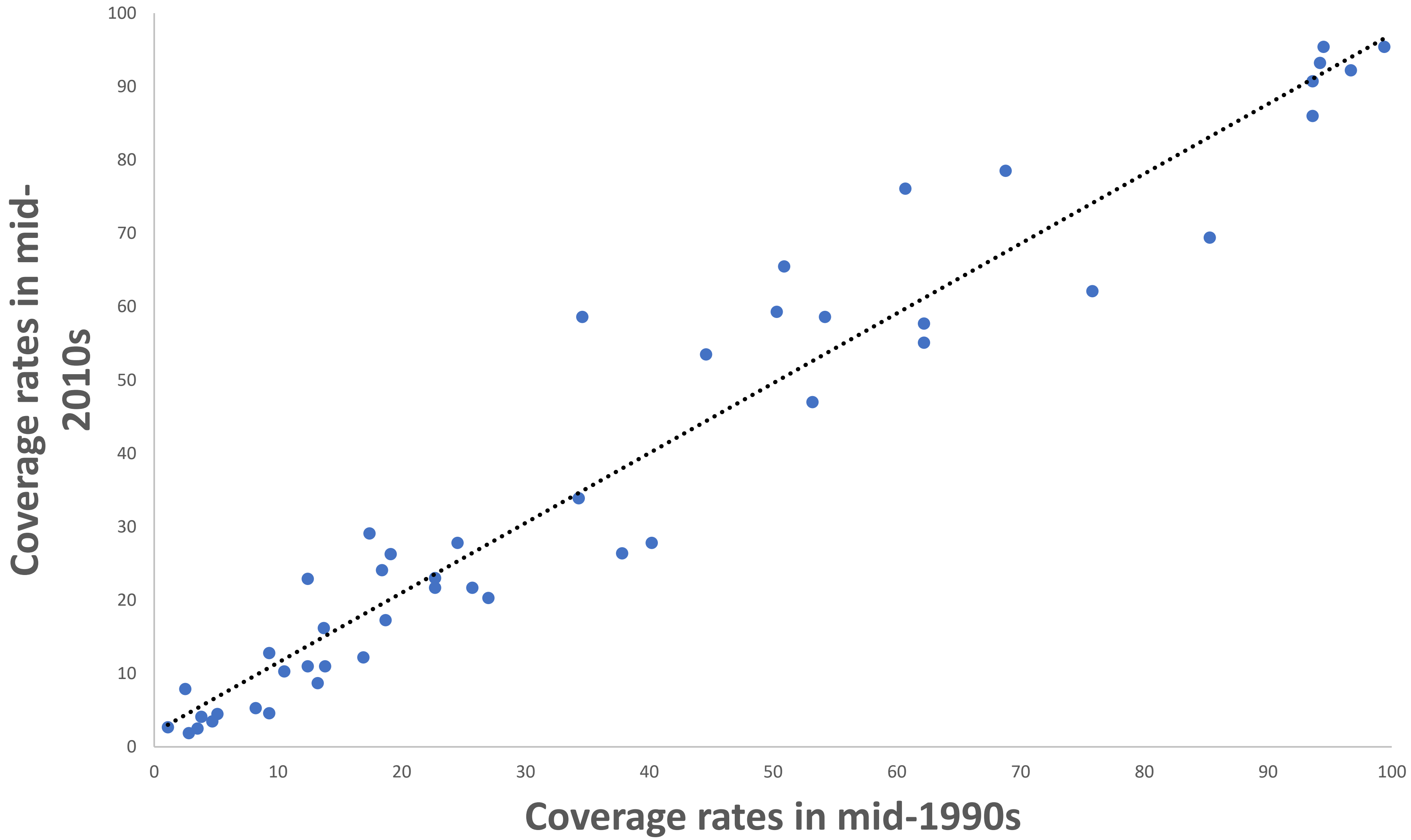




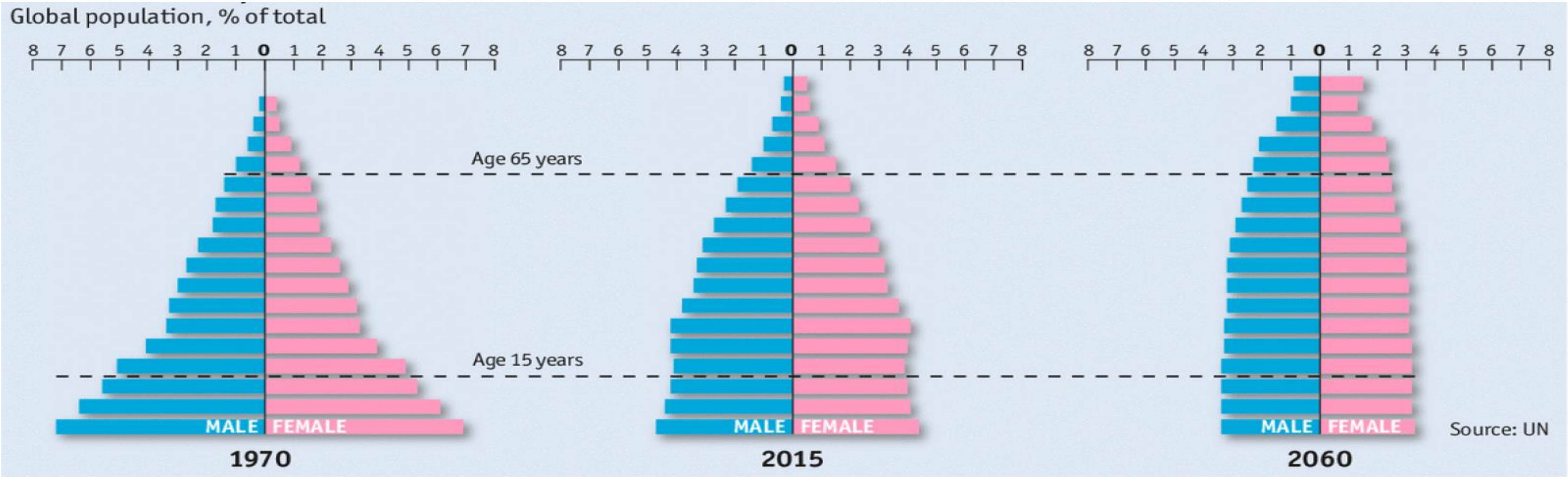
Source: Gatti, R. et al (2014): "Striving for better jobs. Informality in MENA". World Bank.

ECA: Eastern Europe and Central Asia
LAC: Latin America and the Caribbean
EAP: East Asia and Pacific
SA:South Asia
SSA: Sub-Saharan Africa

The coverage challenge: non-coverage persists



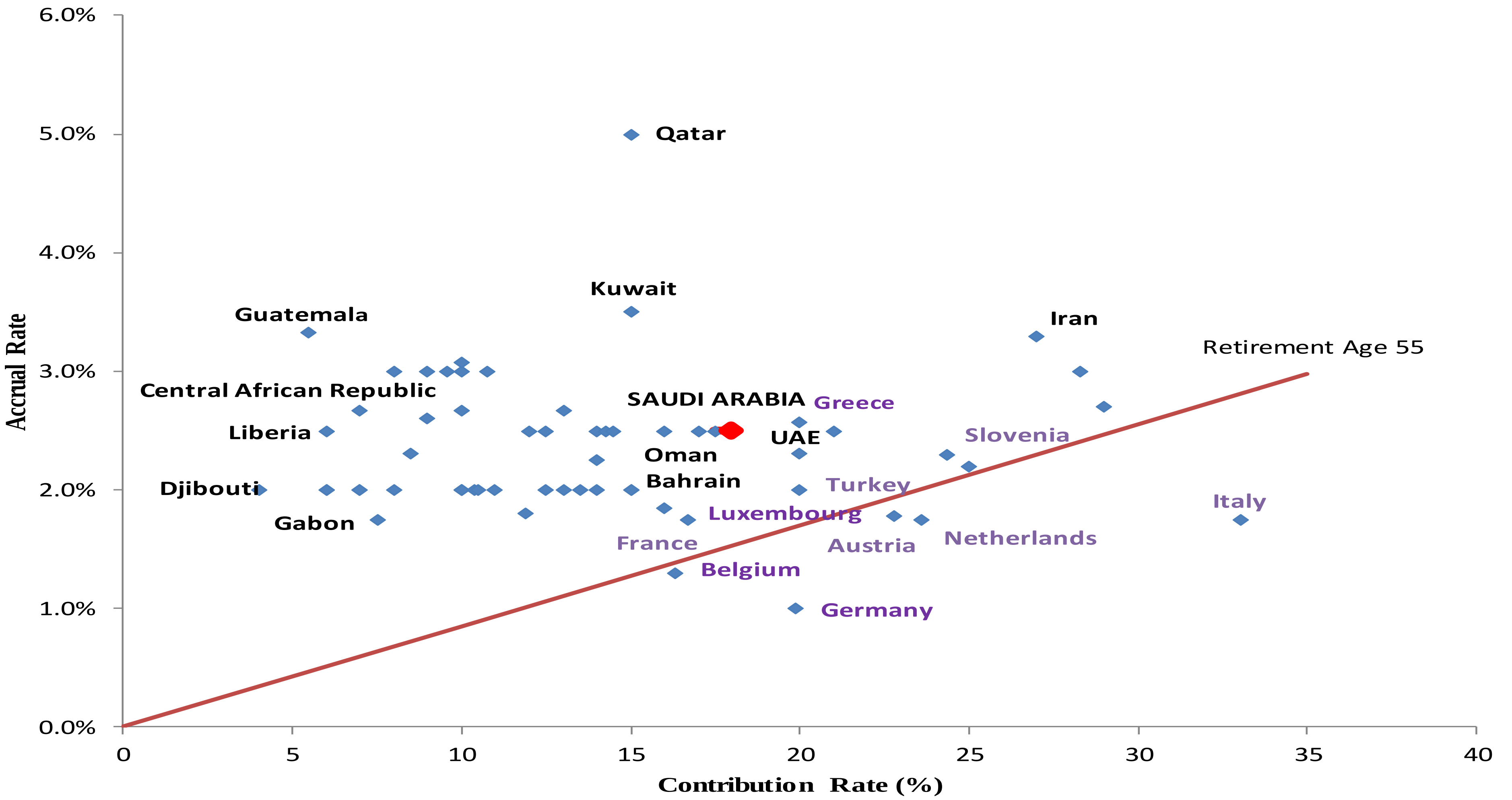
Sustainability challenge: The end of the demographic dividend



Mainly due to:

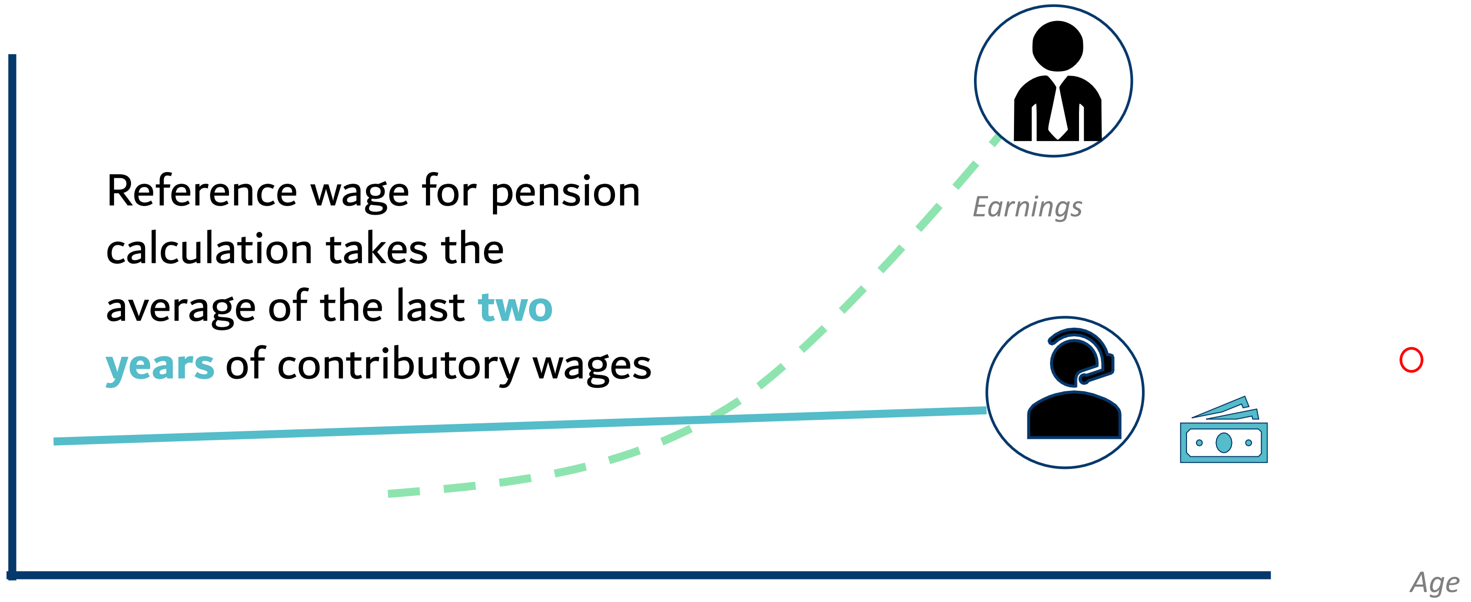
- Increased life expectancy
- Reduced fertility rates

Sustainability challenge: Parametric inconsistencies



Fairness challenge: Pension schemes are (unintentionally?) regressive

- Fiscal support to pension schemes redistribute income from taxpayers to the covered workers
- Benefit formulas based on last salaries benefit those workers with steep income profiles, who are higher income earners and those with highest levels of education



- Early retirement benefits those who can find a new job after retirement. Also usually those with professional background
- Earlier retirement age for women results in lower pensions and amplifies the earning gap between men and women

… and they often have the wrong incentives

- Incentives to:
  - Retire at a young age
  - Under-report wages at early phase in the career (when benefit formula is based on last salary)

- Lack of incentives:
  - To seek private sector jobs (preference for public sector in countries where public sector coverage is higher and pension rules are more generous for civil servants than the private sector)
  - For women to participate in the labor force (same vesting period as men, some survivorship pension schemes)

New challenge: the changing nature of work

- Labor markets will evolve towards more flexible jobs and self employment, for which the contributory Social Insurance schemes have been largely unsuccessful.
- The new digital economy will require adapting the programs designed to traditional employment modalities (wage employment under a single employer);
- To prevent from further reduction of covered population, pension systems will need to rely on a stronger combination of minimum noncontributory pensions (to ensure an extended coverage) and **retirement savings** or **tightly income related DB** (to ensure income replacement).

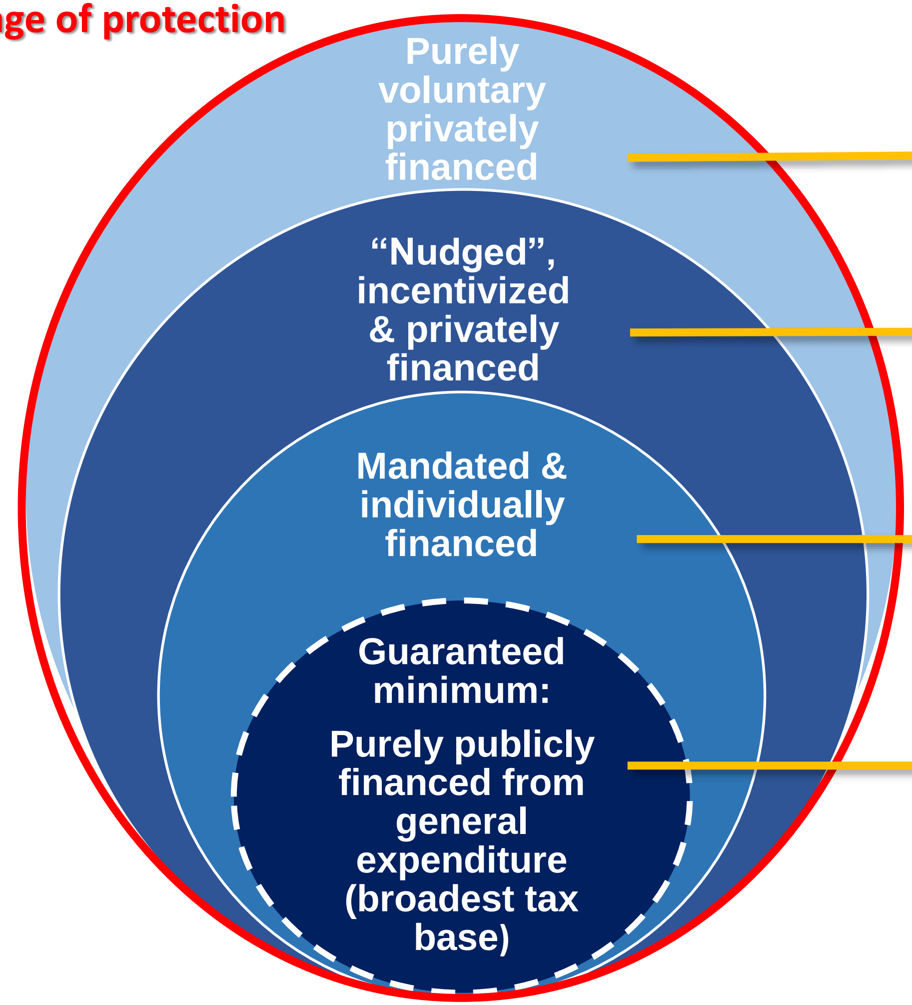
The digital economy: Adapting Social Protection and Labor policies

- **Paradigm shift in Social insurance:** driven by
  - changes in the world of work
  - technological change
- The paradigm change may imply a greater space for:
  - **Flexible retirement**
  - **Savings schemes**
  - **Broad-based (targeted) non-contributory minimum benefit**
  - **Use of technology for service delivery**
- … and a greater need for:
  - **coordination with current Social Assistance programs**
  - **IT platforms**
  - **Lifelong education**

What might a future social protection policy package look like?

(World Bank's Social Protection White Paper)

Policy package of protection



Regulated market provision of secure savings & insurance;
Micro finance saving & insurance

Default opt-ins;
Information

Minimal "adequate" smoothing
N/DC accounts;
Actuarially-fair DB

Minimum guarantee

- Transfers;
- Subsidized premiums**

Prevents poverty and catastrophic losses

Sufficient to ensure income above the minimum, safeguarding against moral hazard

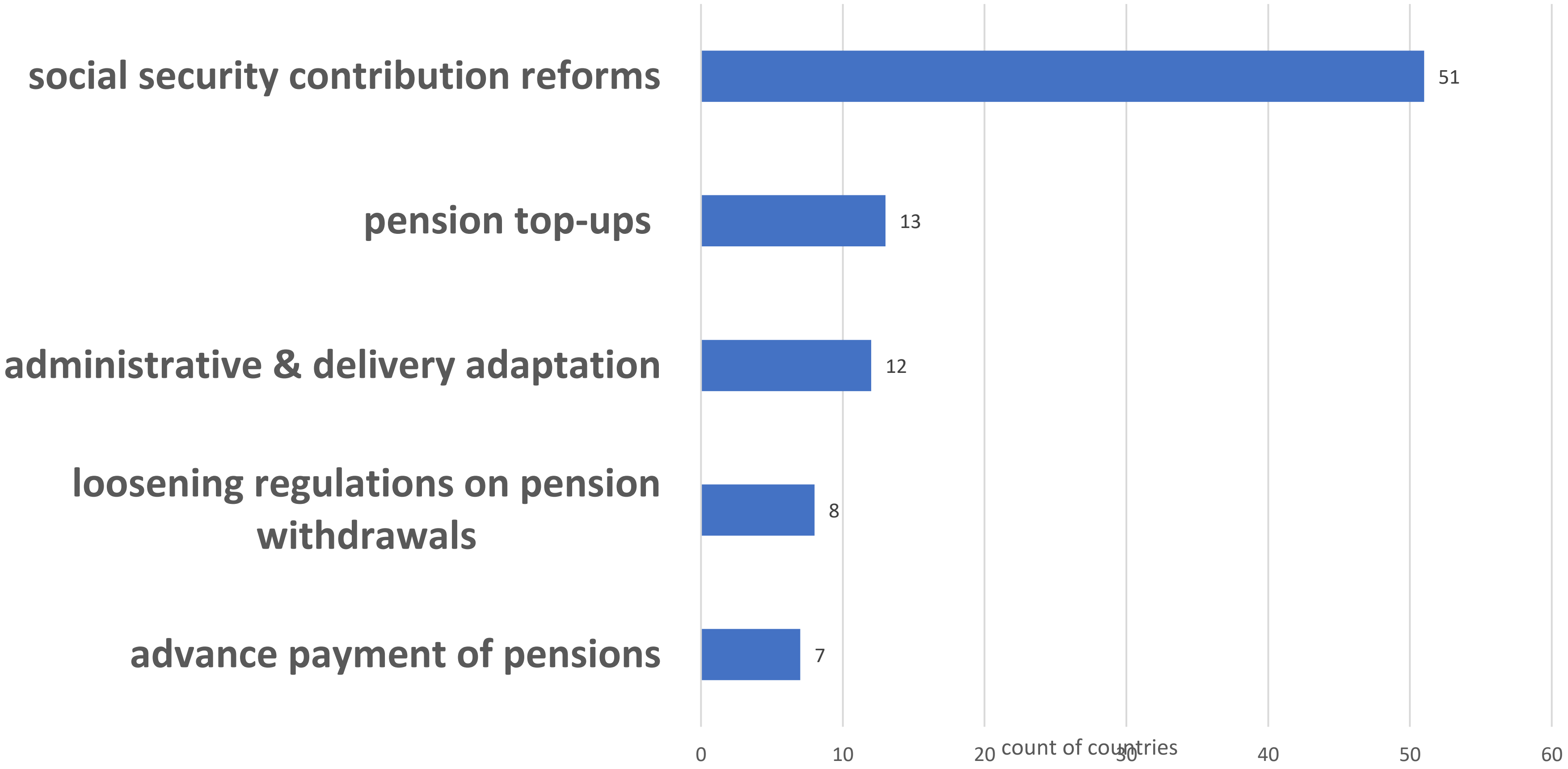
Digitally enabled

** Replaces contributory minimum guarantees and tax incentives

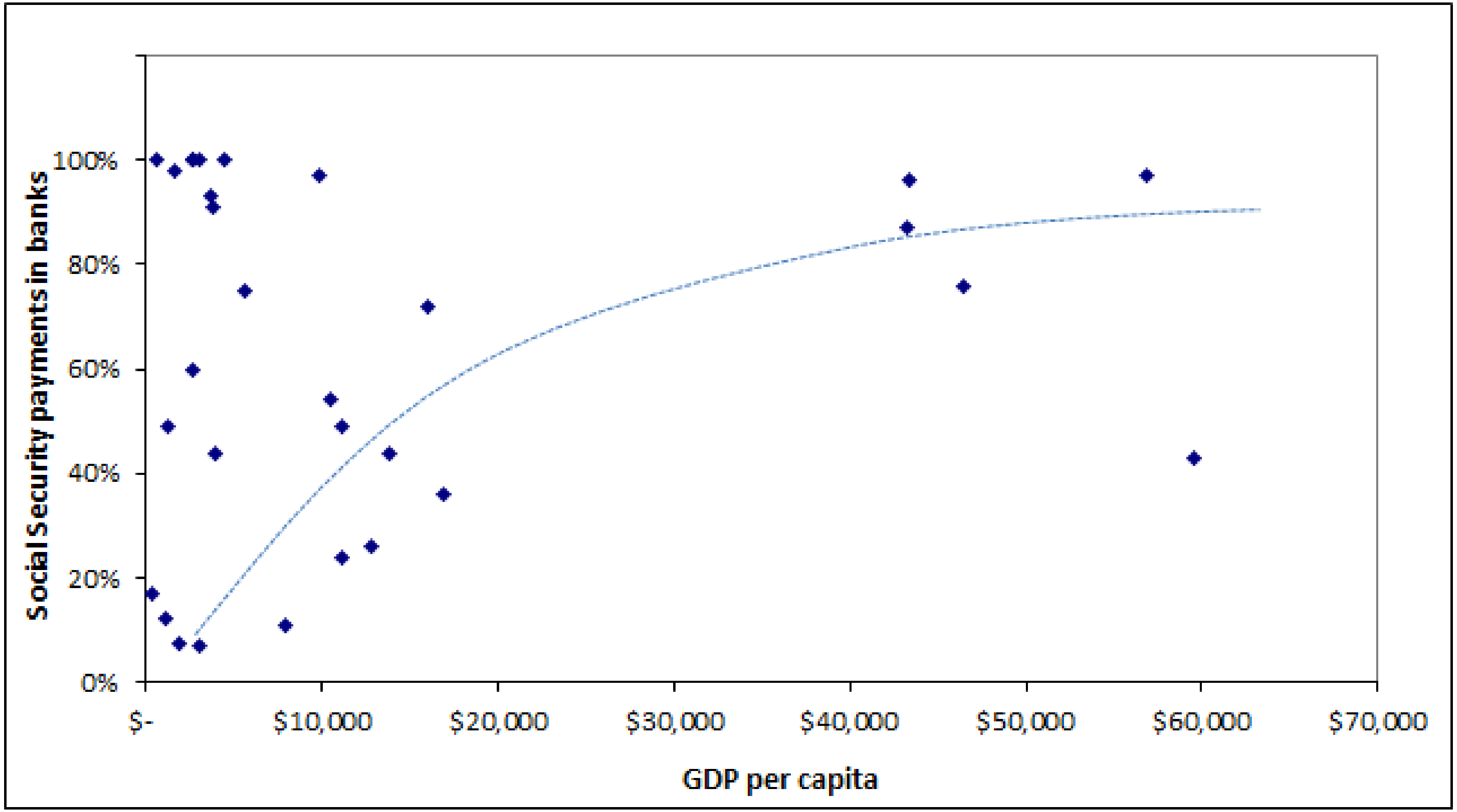
The turbulent 2020: COVID challenges for pensions

- Elderly and Persons with disabilities are particularly vulnerable to COVID-19.
- But Pension increases are expensive, and the crisis also affects the continuity of jobs and the ability of many workers and employers to continue paying contributions to Social Insurance programs
- Future pensions may be result lower due to the loss of contributions, early withdrawals and lower returns on pension assets
- Payments and IT systems need to significantly reduce face to face interaction and concentration of beneficiaries;

Social Insurance: COVID Response



Low-income countries still have a small proportion of pensions paid in bank accounts



Forward looking

- Compensatory measures: Stronger focus on pension reforms
- Increased focus on different modalities of work (self-employment, flexible work, gig economy)
- Link social insurance programs to improve emergency response to multiple risks
- Faster development and access to IT solutions (payments and service delivery)
- Lifelong learning to support longer careers
- Stronger focus on long term care and active aging