

Introduction to old-age pension

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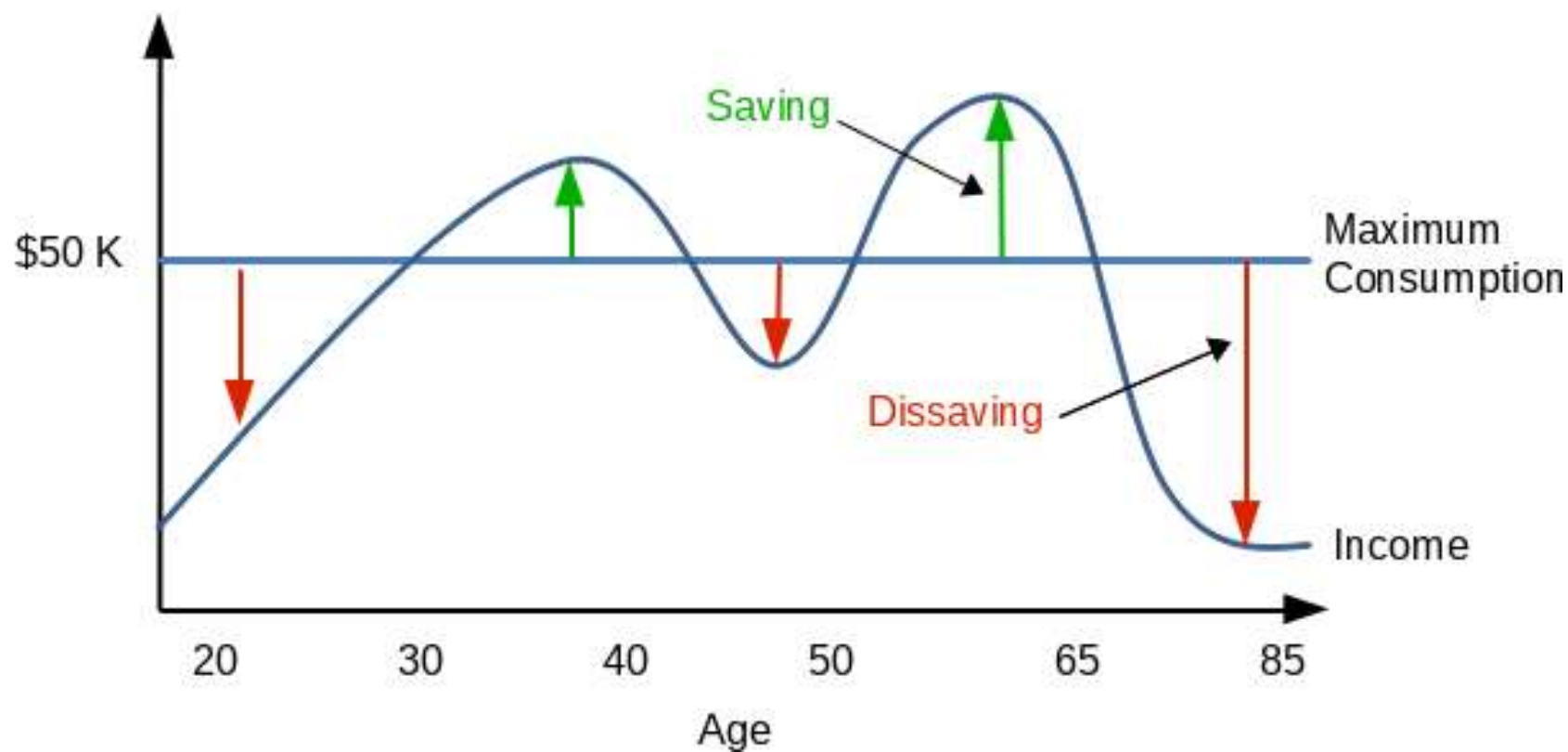
Pension Objectives





**What are
they
doing?**

Income smoothing





Support
individuals

To live better in a world
dominated by uncertainties

INSURANCE

How long will I live after
retirement?

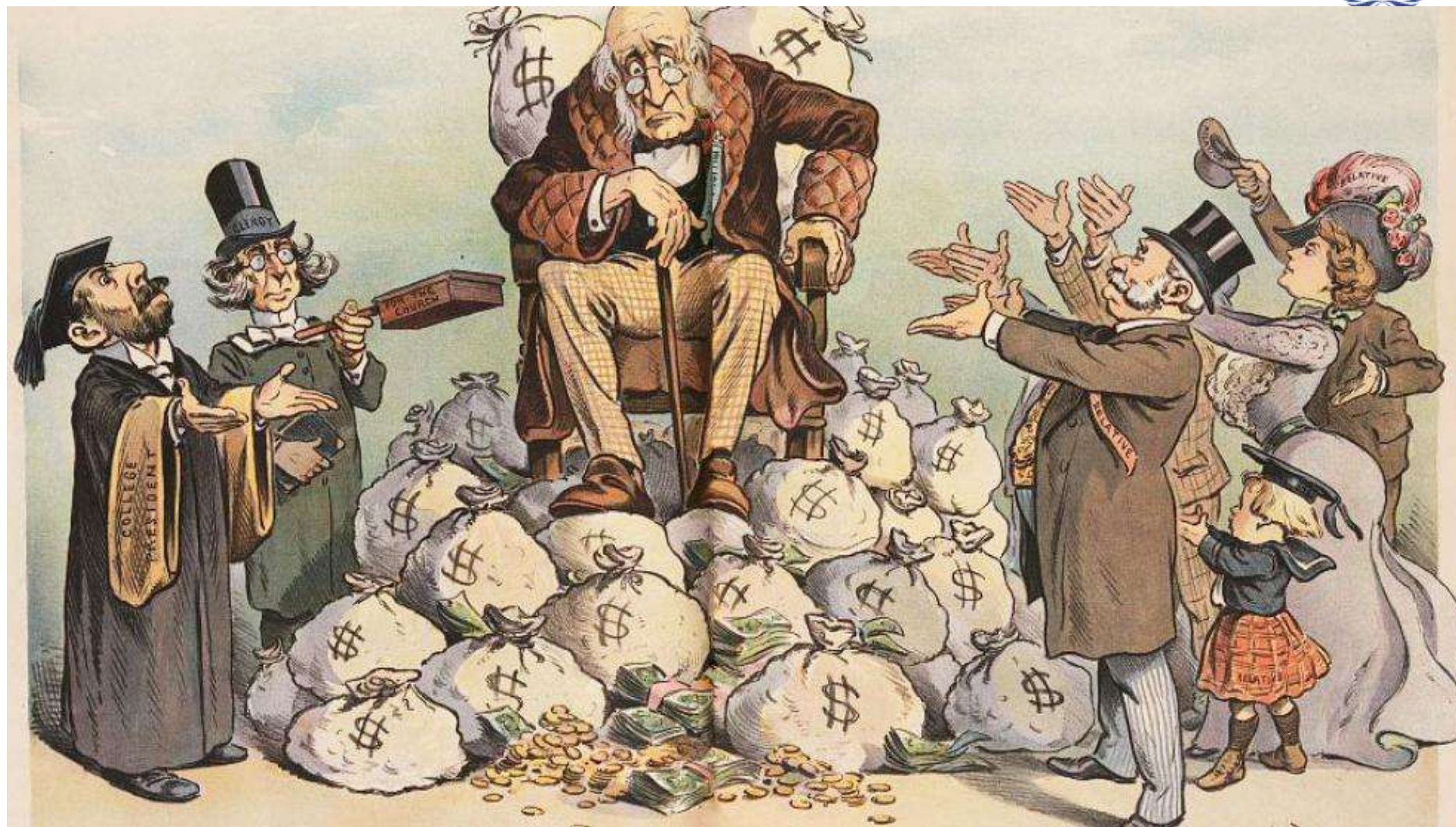
How will the economy
perform?

What will be the inflation?



100
1919-2019

SOCIAL JUSTICE
DECENT WORK



Redistribution

Within the same
generation

- Formulas can provide low earners with a higher percentage of their previous earning
- Subsidize the consumption from who is less well-off but not necessarily poor

Between
generations

- Promoting a transfer from the future to the current generation
- By setting a lower contribution rate in the early stages
- Expecting that future generations will have higher wages due to economic growth and productivity increases



Poverty relief

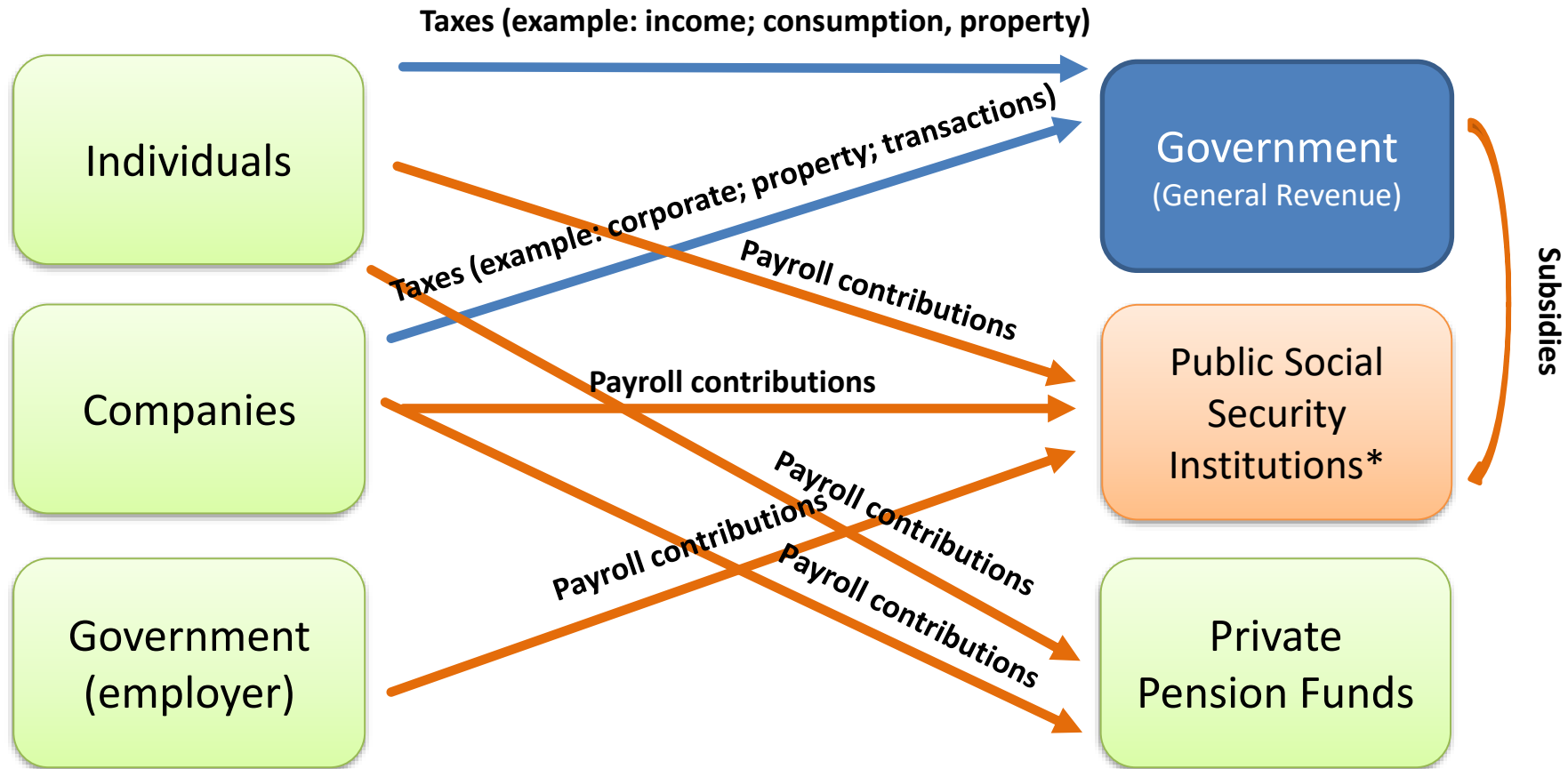
Transfers

For those who do not have the capacity to earn enough resources

Pension systems



FINANCING PENSIONS

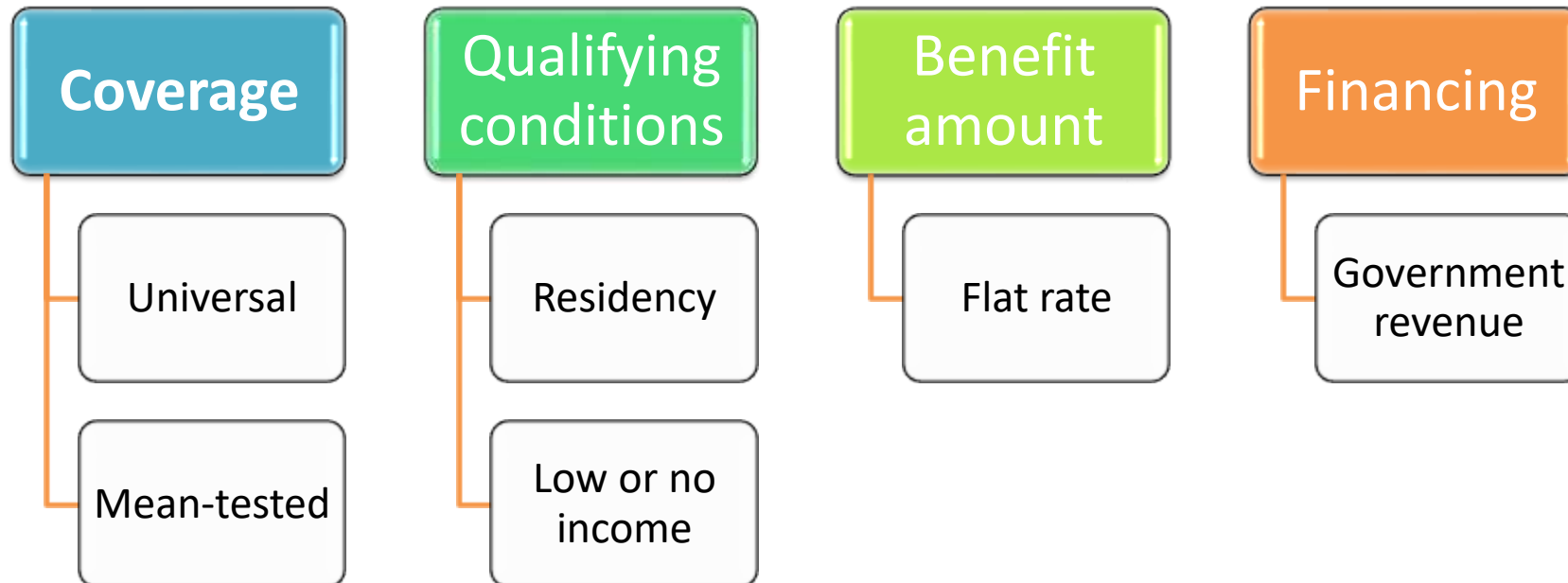


* Might include also public provident funds

Pension Design:

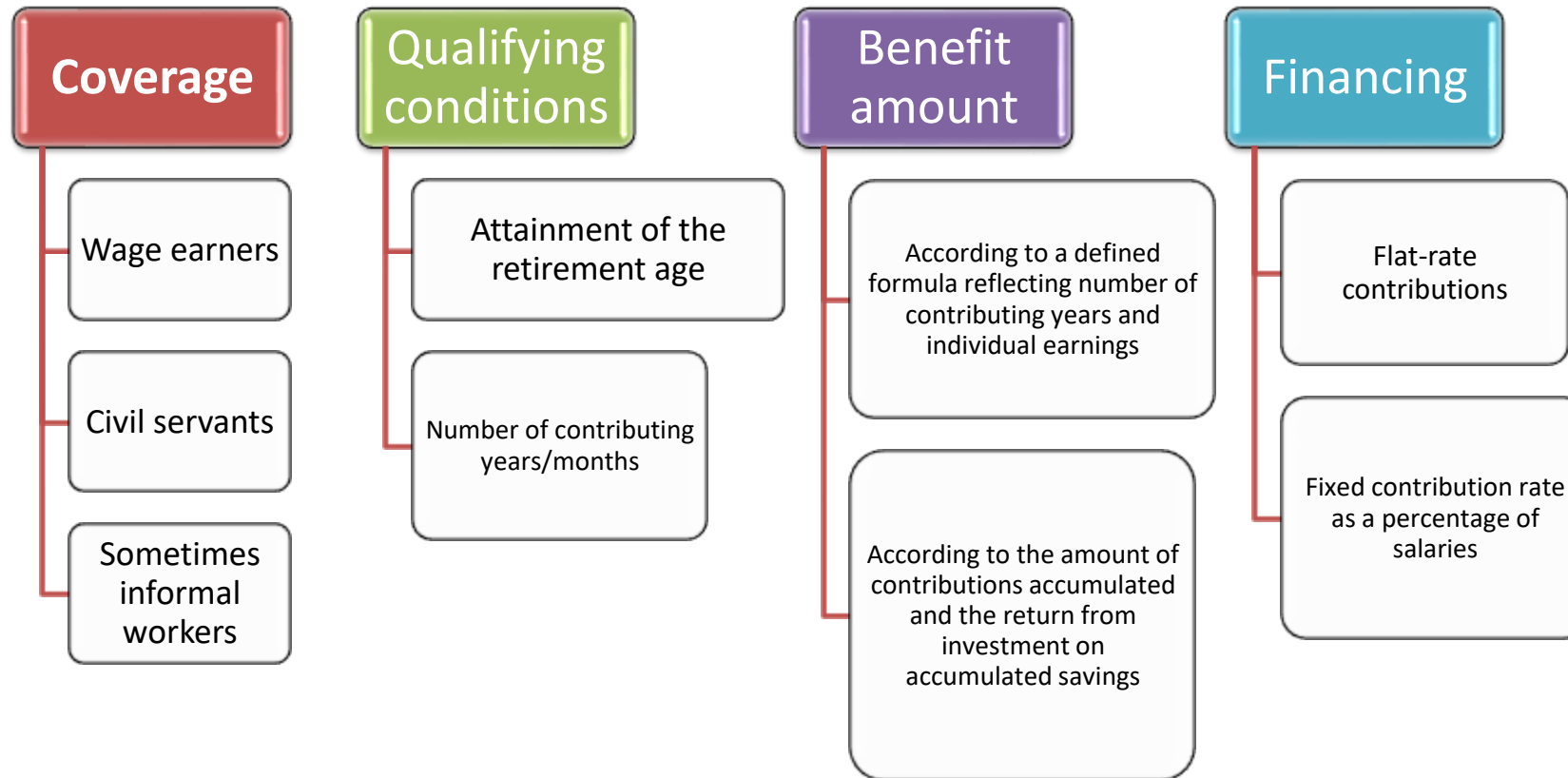
Tax-based scheme

For those who reach or are already in retirement age but did not had the chance/capacity to contribute to their pension



Pension Design:

Contributory social insurance scheme



Defined-Contribution (DC)



Strong tie between contributions and benefits

Based on individual saving accounts

Contributions are accumulated in the account and credited with investment returns

At the moment of retirement beneficiaries can receive a lump sum payment or can purchase annuities

Defined-Benefit (DB)

Benefit calculation established by laws/ regulations

Level of benefits determined by a **formula** that defines the relation between the pension and the **beneficiary wage history**,

Contribution schedules planned based on future projections

Assets are not in individual accounts but instead in a central pool

Global Debates

Defined
Contribution vs
Defined Benefit

Lump Sum vs
Regular Payment

Private vs Public
Provision

DB scheme

Amount predictable due to pension formulae

Redistribution for low income earners / short-career workers and between generations

DB scheme

Substantial roles for poverty alleviation, income smoothening as well as economic stabilizer

Contribution rate gradually increased from low to high in line with the economic and social development, including ageing

DB scheme - challenges



Sustainability - increasing cost due to ageing if parameters are not adjusted

Political challenges of consensus building to contentious issues such as retirement age increase

DC scheme - Advantages

More intuitive – I get what I paid

Less risks for the State – you get what you paid

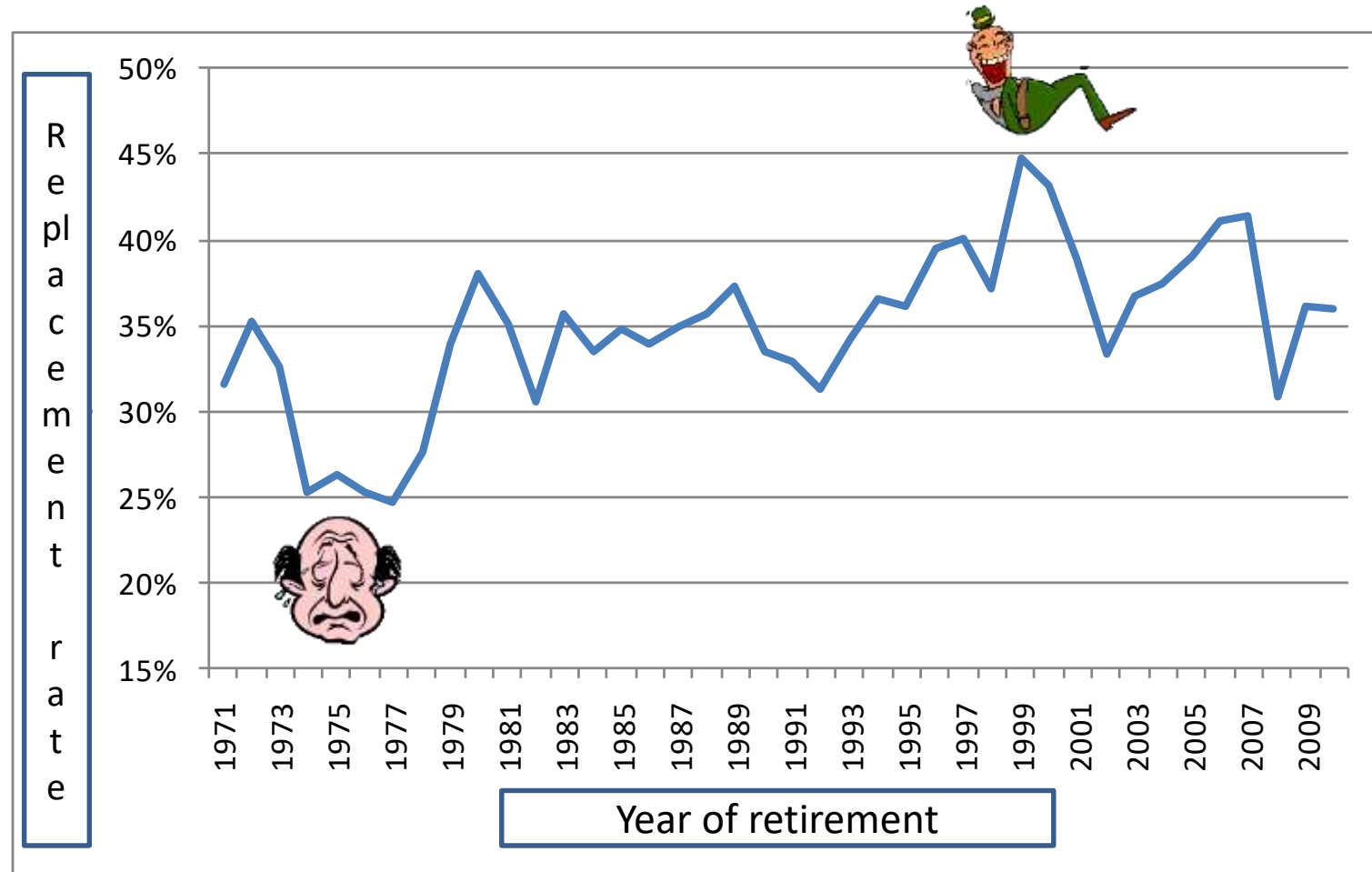
DC scheme - Challenges

Amount unpredictable due to unknown investment income

No redistribution hence weak protection for low income earners / short-career workers

Higher contribution rates even at the outset of the scheme for meaningful benefit level

Even in Canada, DC are swinging!



Notional Defined Contribution (DC)



- Functions as a DC scheme, but contributions are only virtually accumulated in individual accounts
- Returns from the amount accumulated are credited to the system
- In real terms the “system does not own matching funds invested in the financial market”
- Accumulation in the account follows a rule rather than the actual return on the assets held

Funding Options

Fully Funded

Pensions are paid out of a fund built over a period of years from contributions.

Pensions are based on savings: contributions are invested in assets, the return on which is credited to the system's fund.

- the level of reserves at any point in time is theoretically sufficient to cover all the future pension liabilities that have already been earned.
- Defined contribution schemes are automatically fully funded as their liabilities to the individual contributor are always equal to the amount he/she saved.

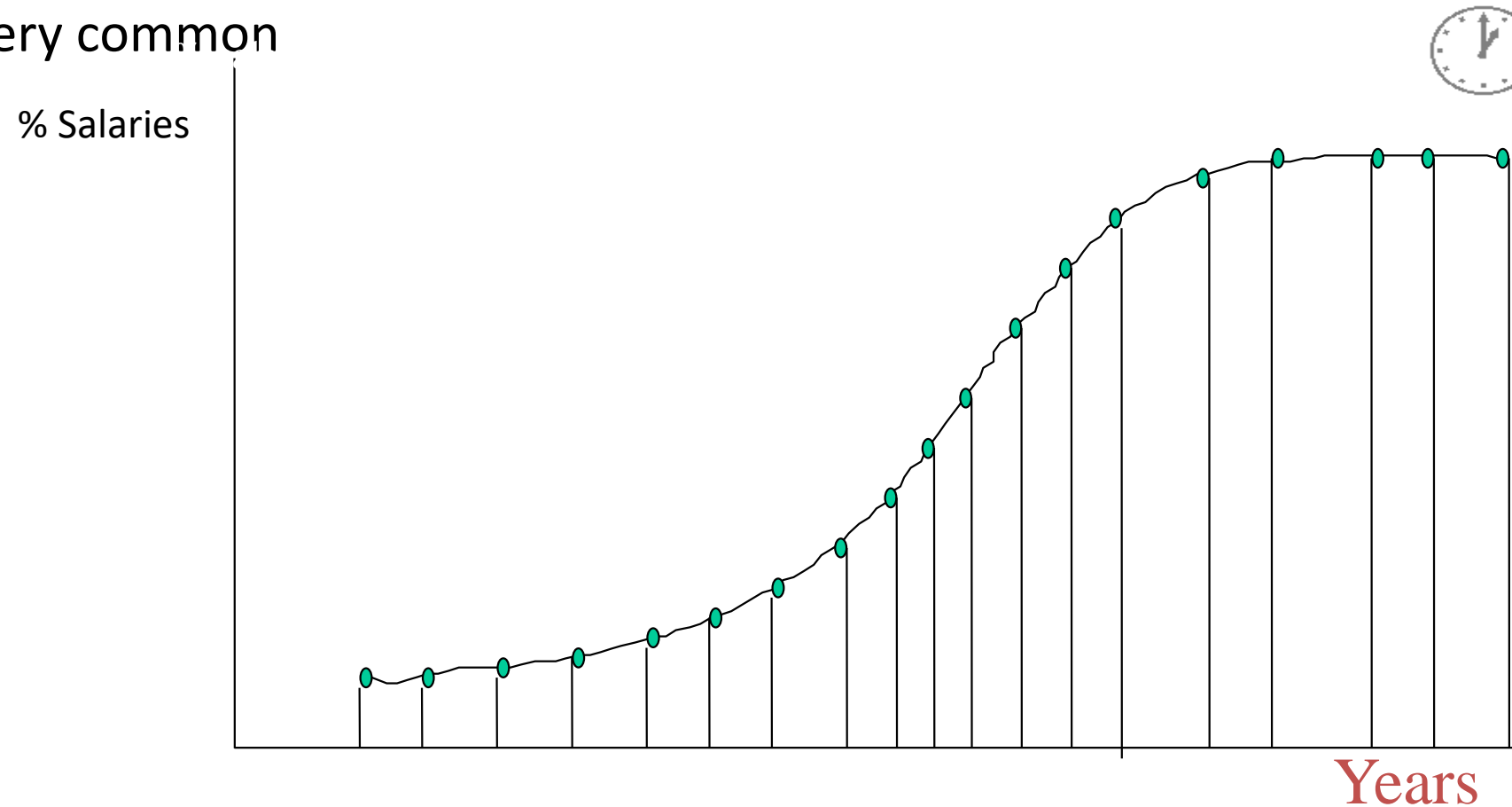
Funding Options

Pay-as-you-go (PAYG)

- Pensions are paid out of current contributions.
- Very low level of reserves required
- Rely almost exclusively on the future contributions of the active generations to pay the pension of each contemporary pensioner generation

Pure PAYG model

- Contribution rate would adapt annually to cover the benefits that would be paid
- No reserve is created
- Not very common



Funding Options

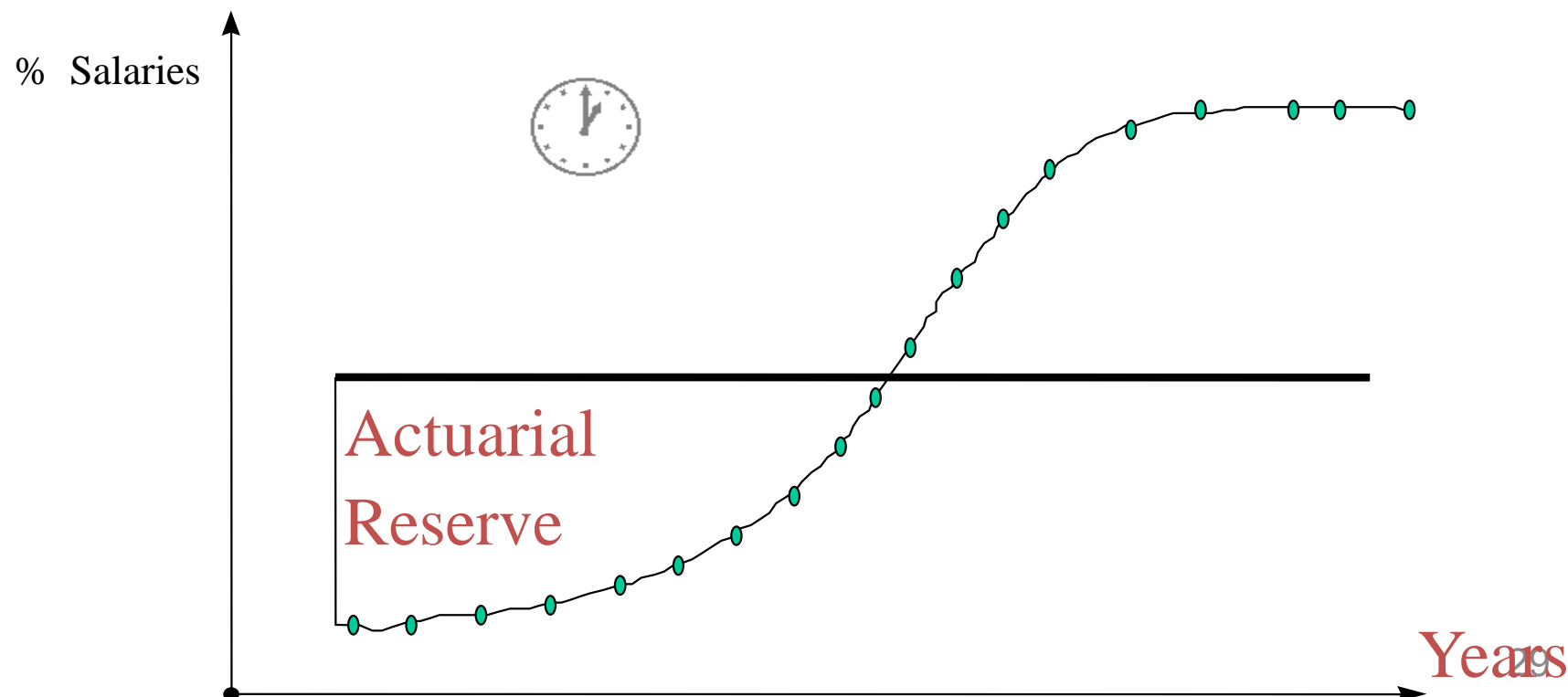
Partially Funded

Payment of pensions are out of a combination of current contributions, returns on assets and sometimes their sale

- The pension schemes at any point in time have to have a certain prescribed minimum level of reserves.
- However, that amount is generally less than the actuarial equivalent of all their future liabilities.
- The reserve level is generally defined by law.
- Partial funding in a mandatory social security scheme can be justified since most of the future liquidity is guaranteed by the fact that there will always be new generations of contributors who will have to provide revenues to the scheme

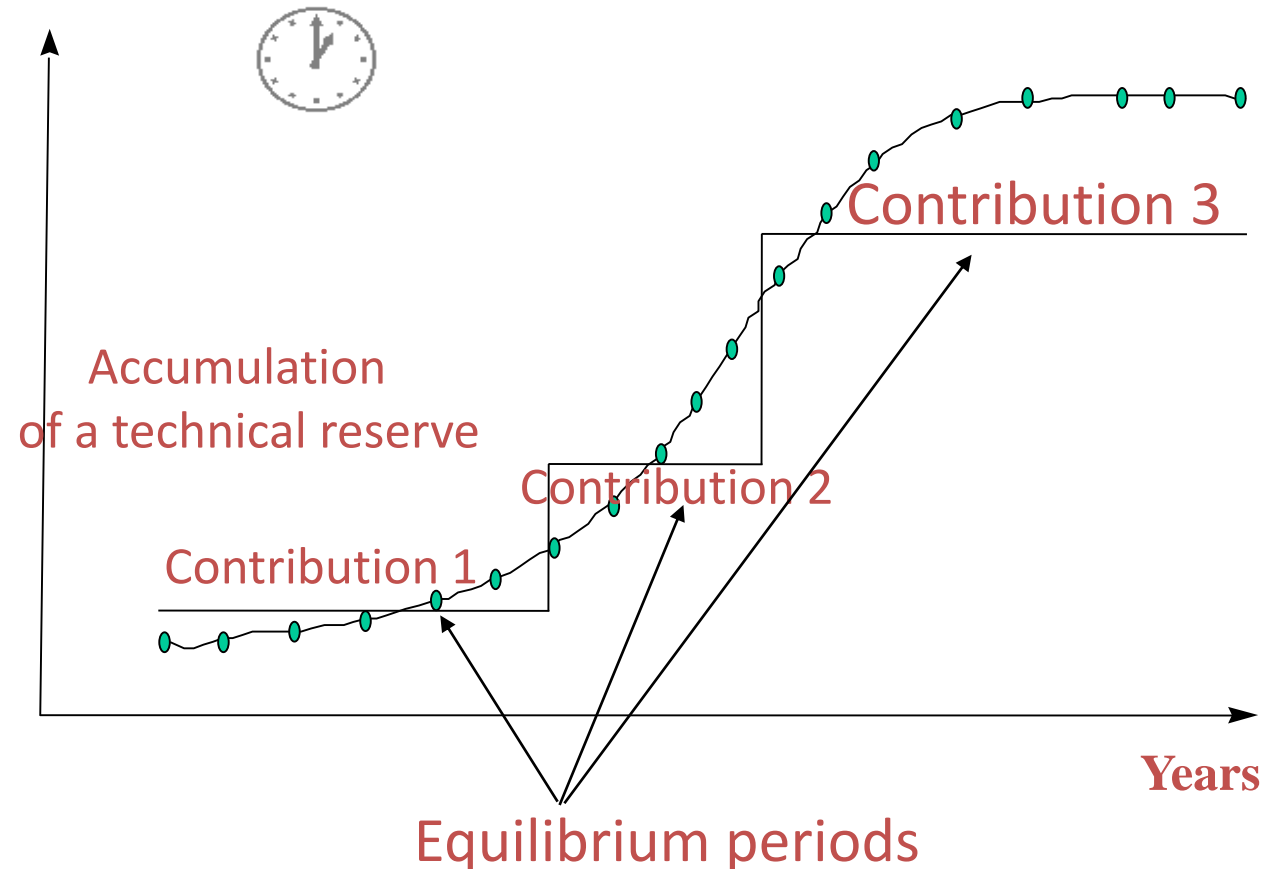
Partially funded (I) General Average Premium

- An average of the PAYG level over a period is defined and the level of contribution is established for the period
- During the initial phase the contribution collected exceed the costs with benefits and therefore a reserve is created
- The reserve is used to pay benefits when the system matures and the costs with benefits are higher than contributions

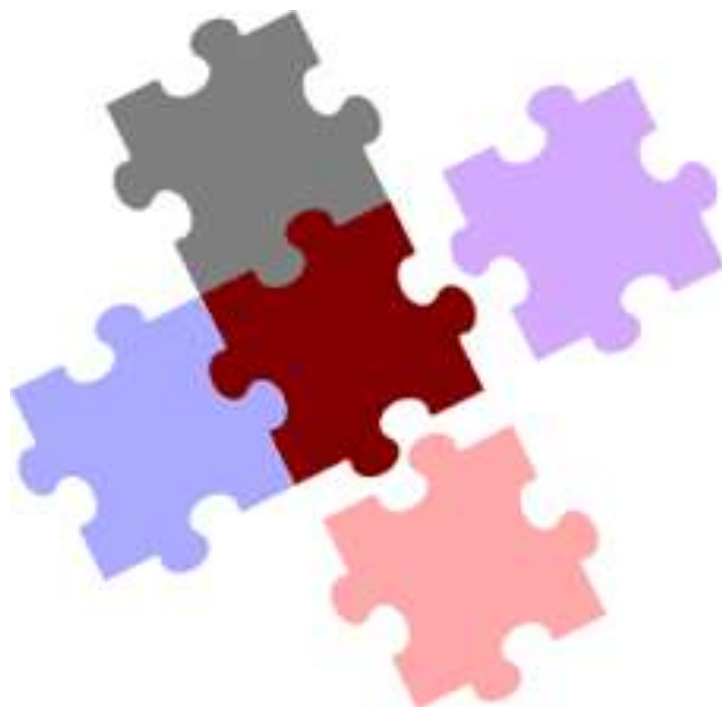


Partially funded (II) – Scaled Premium System

- As in the General Average Premium the contribution level is defined based on the average of expected costs over a period.
- However instead of a single contribution level for all the period, different equilibrium periods are established and reserves are created
- It is a strategy that allows higher redistribution between generations. It is recommended when the economic situation is expected to improve and therefore future generations that are expected to be better off will pay higher level of contributions than the generations in the early years of the system

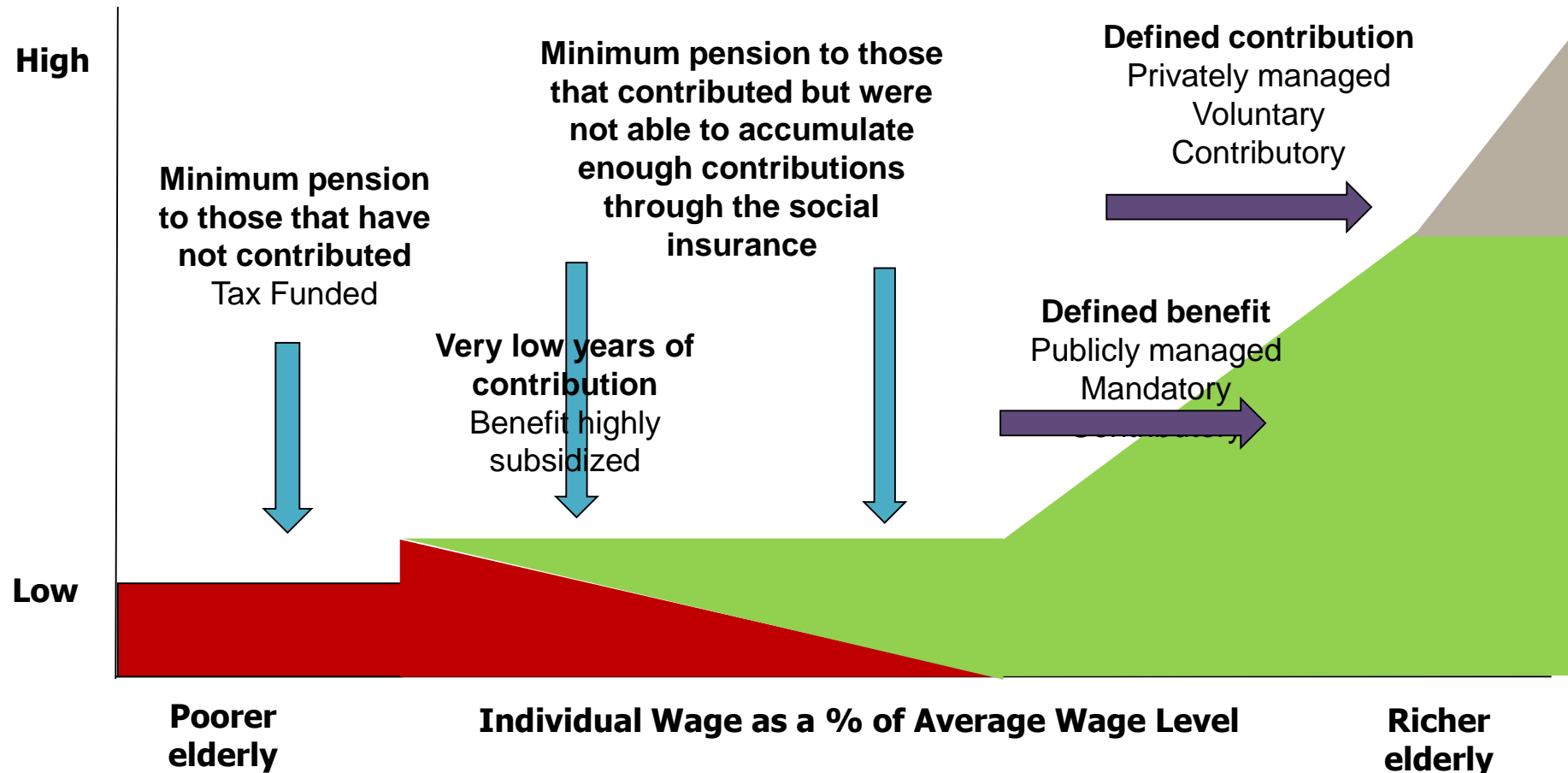


How do modern systems look like today?

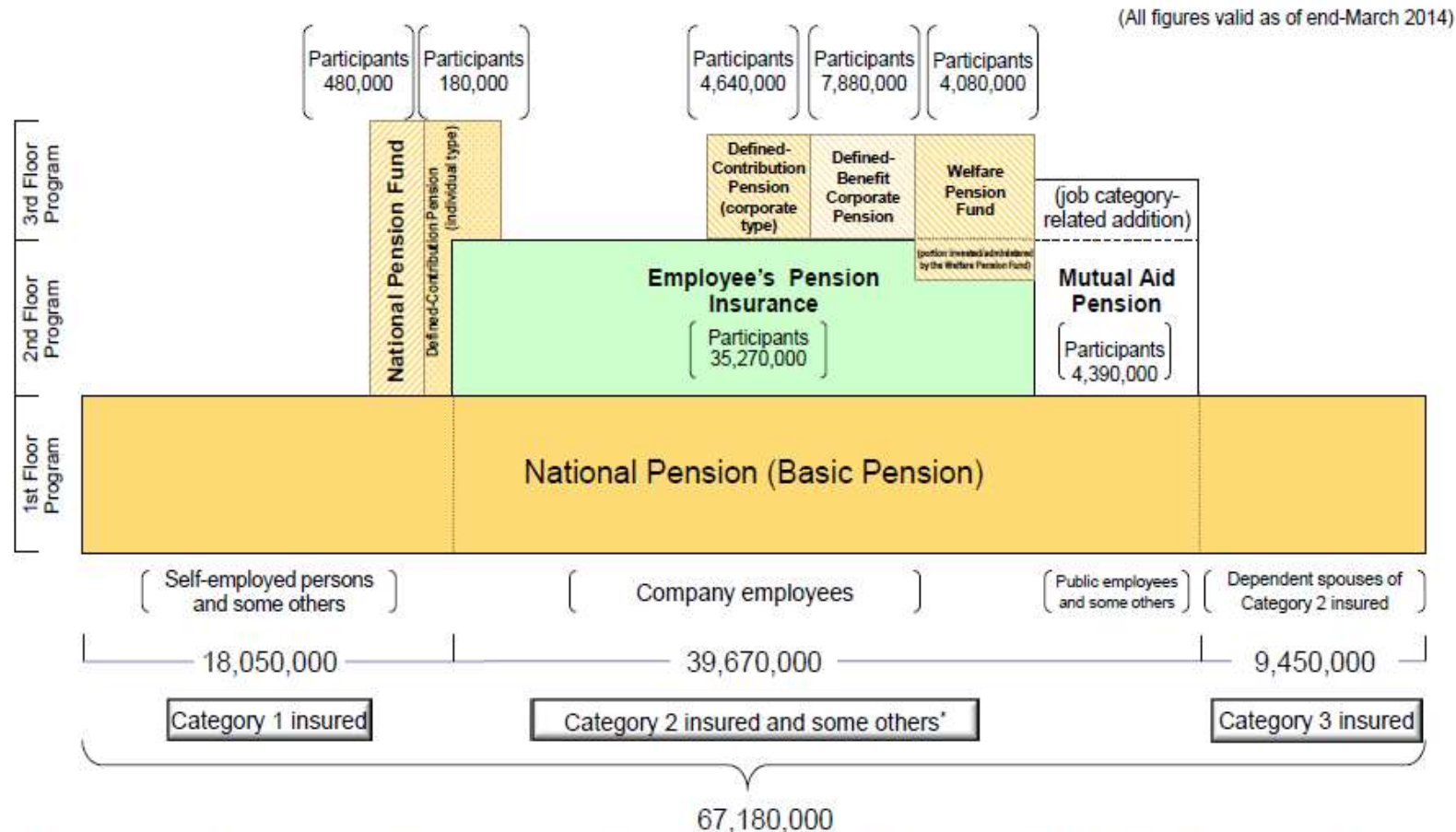


Examples of integrated system combining tax funded and contributory benefits all under one agency

Benefit Level (% of Average Wage)



Universal pension and top-up voluntary pension tier in Japan



CONTRIBUTORY PENSION MODELS IN ASEAN

Defined Contribution

- Malaysia
- Brunei
- Singapore

Defined Benefit

- Thailand
- Viet Nam
- Philippines
- Lao PDR

Combined DB & DC

- Indonesia

► How to support workers in the large informal economy?

- This is an usual question I receive.
- Informal economy is too big.
- Therefore, improving social insurance does not benefits many workers.
- It is discrimination to those who work in the informal economy if we discuss only the scheme for the formal sector.
- The Government should provide more cash transfers to workers in the informal economy because they are more vulnerable.

▶ As a result...

- Indonesia has limited social insurance benefits
- Large social assistance for narrowly targeted population group
- People tend to think social protection should be provided by the Government
- And, employees and employers pay too much

BPJS-TK legal coverage

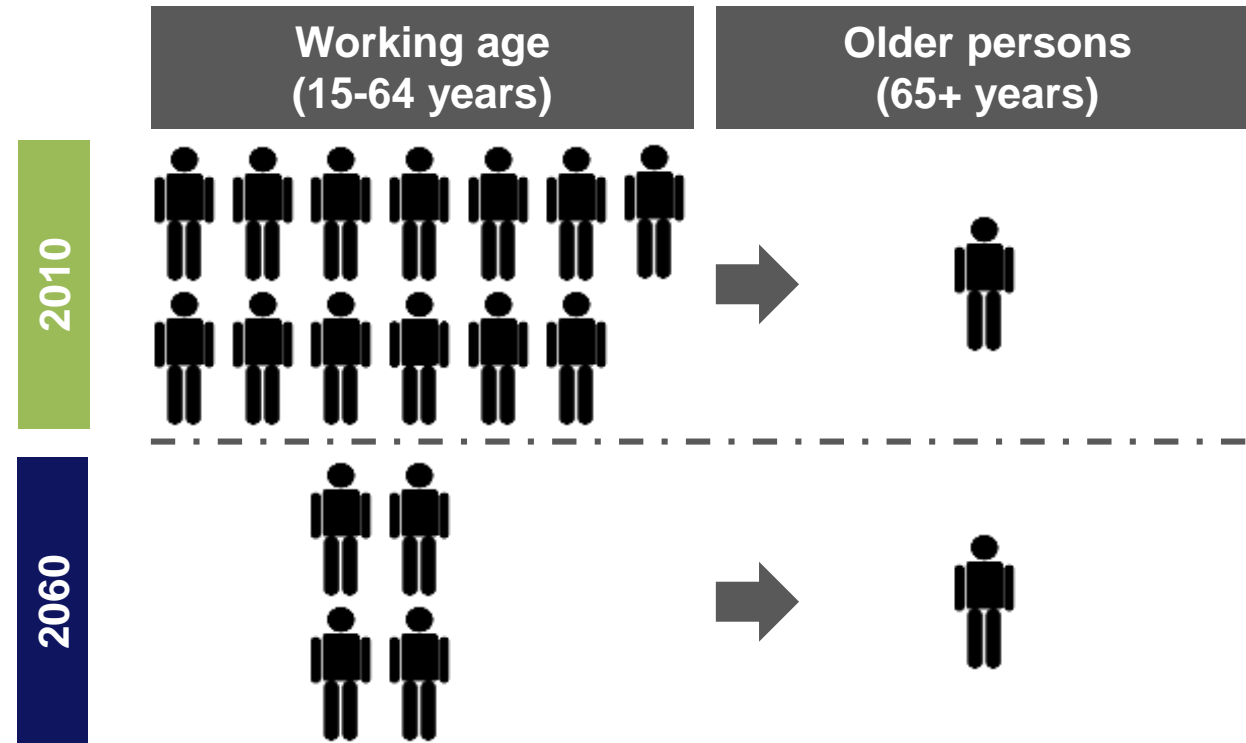
Scheme		Wage worker			Non-wage worker
		Large/Medium	Small	Micro	
Death Benefits	JKm	Mandatory			
Employment injury	JKK				
Old-age saving	JHT	Mandatory	Mandatory	Voluntary	
Pension insurance	JP		Voluntary	Not eligible	

► What will happen if no change is made

- Let us take an example of old-age income security

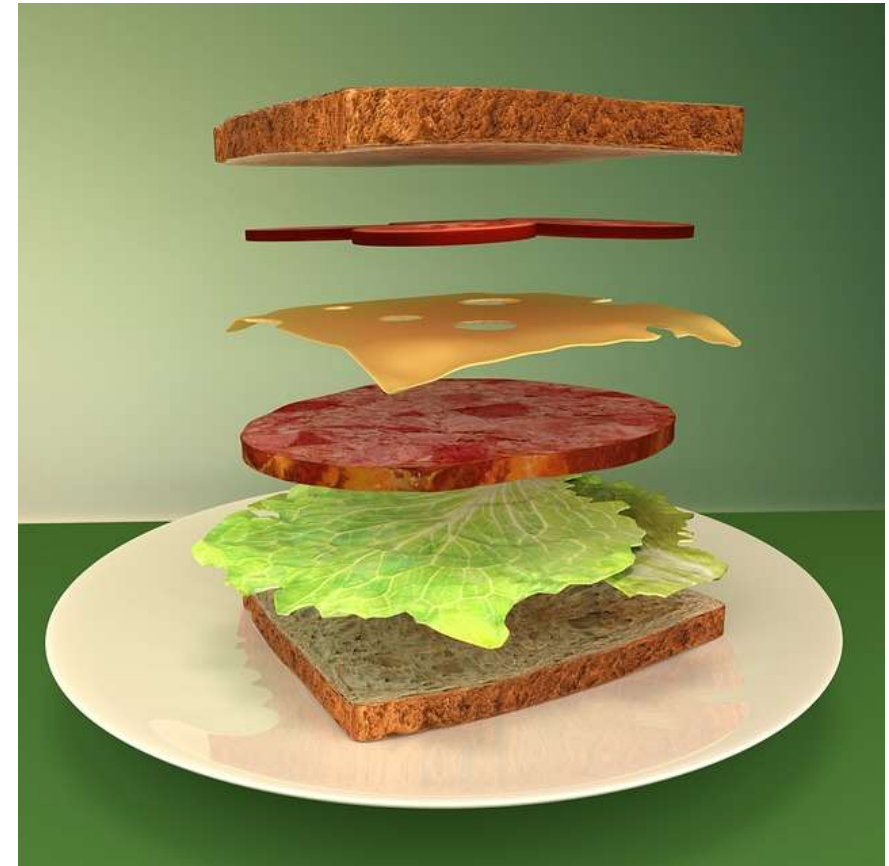
Indonesia will be rapidly ageing

- In 2010, there were 13 working age populations against one older person.
- In 2060, there will be only 4 working age populations against one older person.
- 4 people will have to take care of one older person.



Can savings or wages help millennials?

- The future generation will have to pay much more economic burdens, if they have to take care of parents with their savings.
- Millennials or their children will become a sandwich generation. They will have to take care of their parents, themselves and their children.
- Will you have enough savings?
- Will the Government have enough budgets to support them?



Workers do not see social insurance attractive enough

Limited benefit packages – do not know anyone among friends and families who receive; cannot imagine benefits if they don't see anyone receiving?

- 34 million BPJS-TK active members out of 131 million labour forces
- Only 173 thousands JKK claims
- Only 55 thousands JP claims (DB)
- 1.9 million JHT claims (savings; DC)

Limited legal coverage – People regard JHT as pension. But it has the nature of saving based on DC. The pension is JP. But people regard JP as a rich people's scheme because legal coverage is limited to large-medium enterprises.

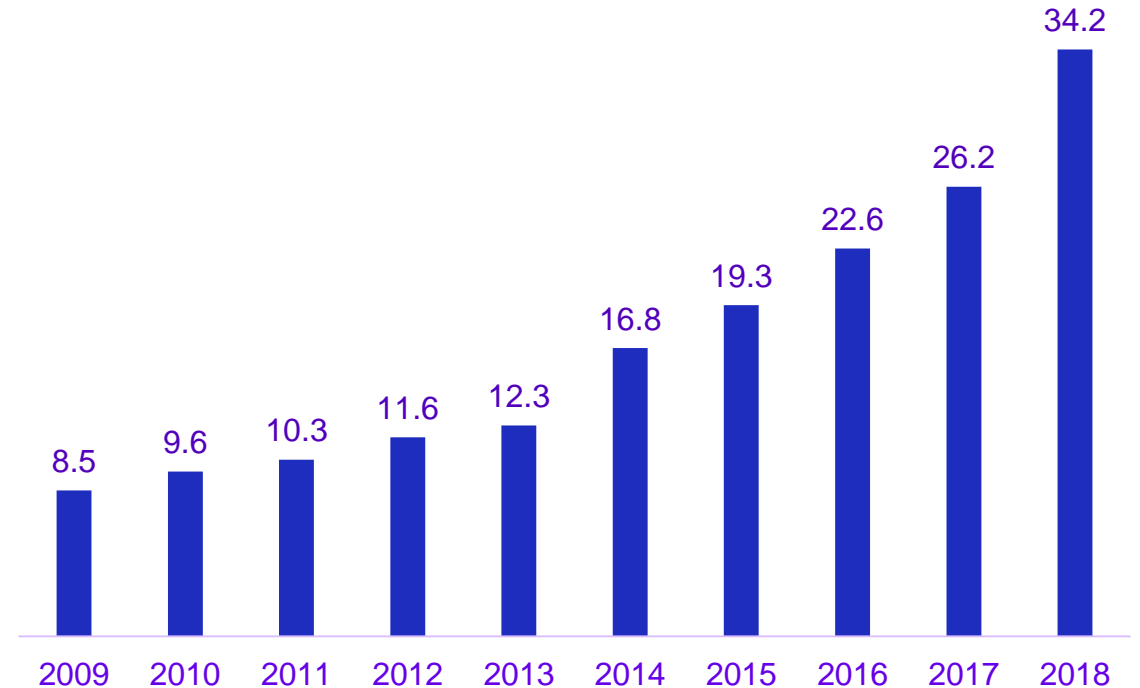
Workers do not see social insurance is attractive enough

- There are very few benefit recipients because of legal coverage and policy designs
- BPJS-TK's administrative efforts on coverage extension are well in recent years

CAGR 5 years 19.43% growth

CAGR 10 years 15.09% growth

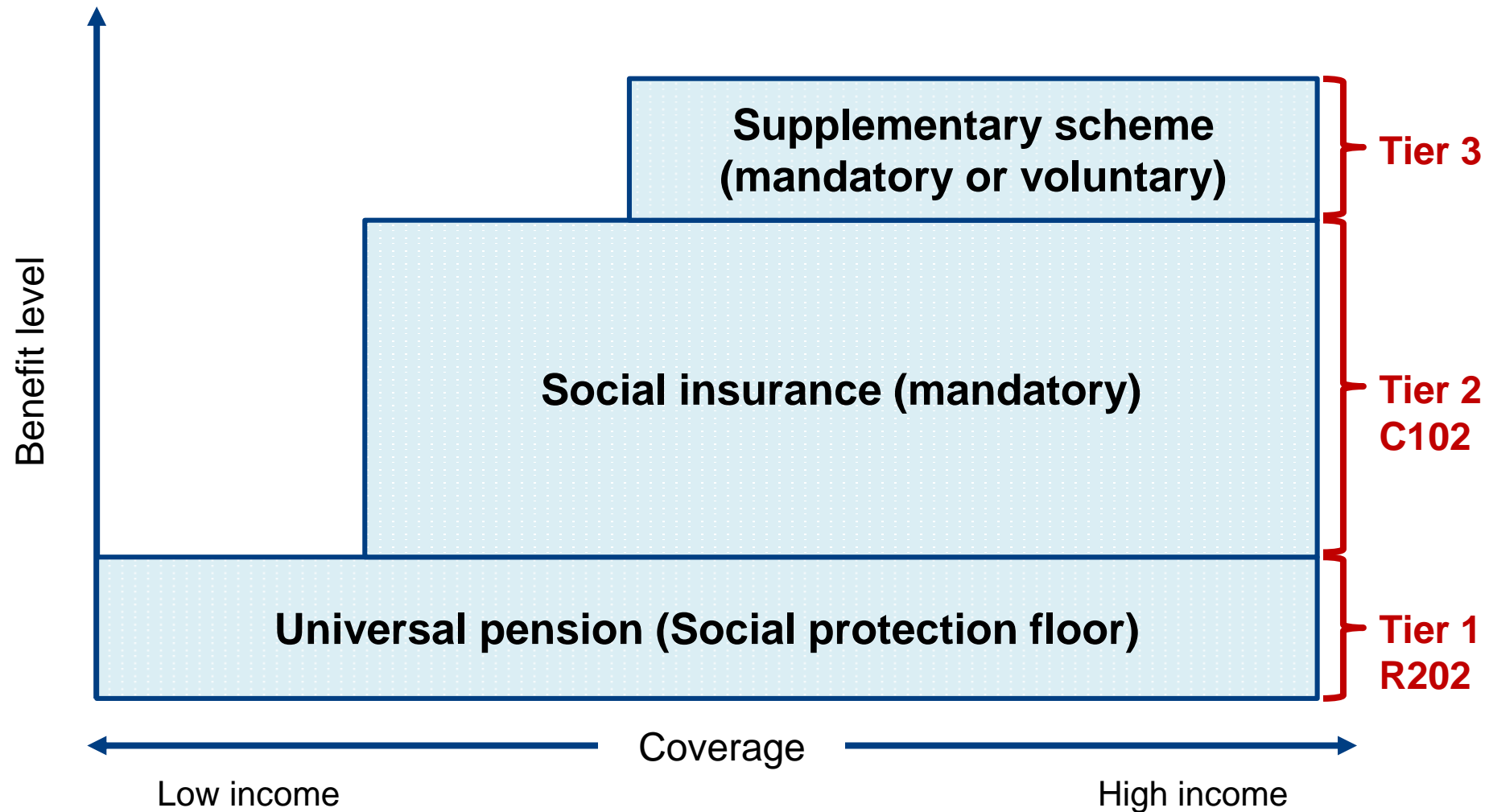
BPJS-TK active contributors



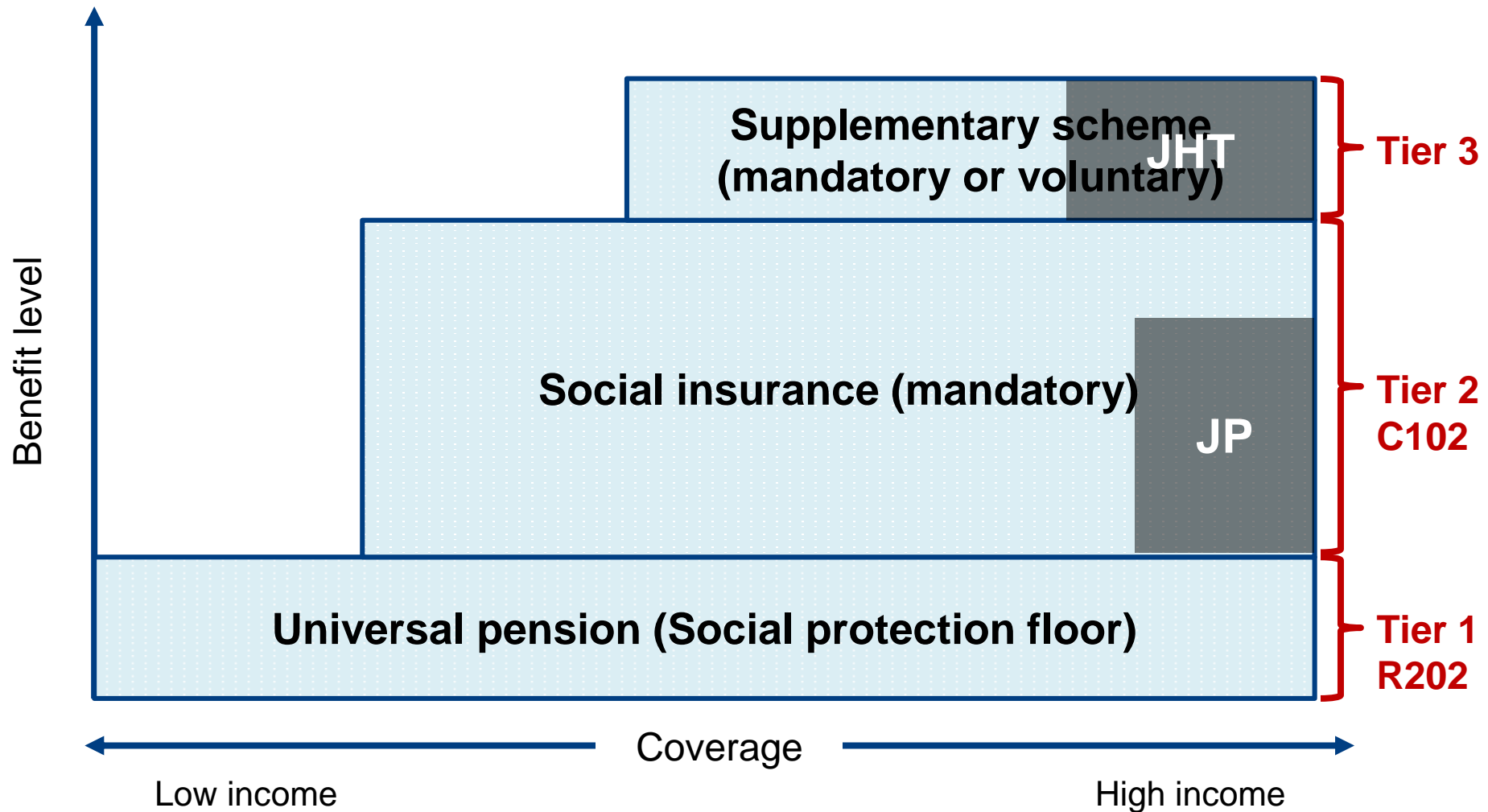
▶ **Extending social insurance through a tax-funded scheme**

- End the division between social assistance and social insurance
- Important to consider how to integrate a tax-funded scheme into a contributory scheme
- SI needs to be at the centre of social protection; because of wider coverage, sustainable, formalisation and higher benefits

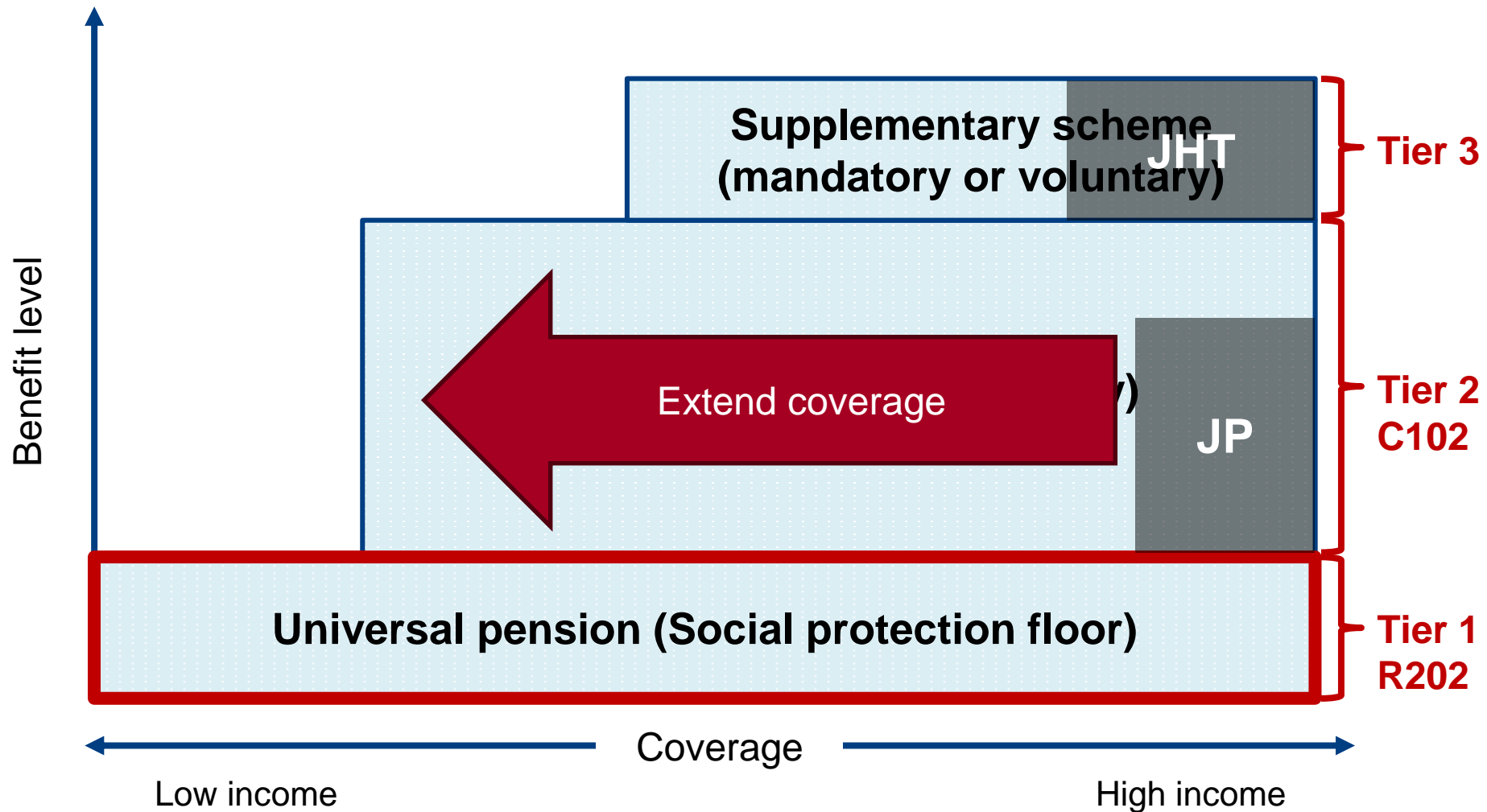
Multi-tier model for old-age pension



Multi-tier model for old-age pension



Multi-tier model for old-age pension



▶ Extending social insurance by improving SI benefits

Introduce short-term cash benefits would improve SI benefits and attract more workers to participate in the SI

- Unemployment cash benefits
 - Maternity cash benefits
 - Sickness cash benefits
-
- Currently these benefits are on employers' liabilities; it depends on whether workers can receive these benefits. It is uncertain for workers and always create unnecessary conflicts over these issues.

Extend social insurance by improving SI benefits

Country	Family	Maternity	Sickness	Unemployment	Employment Injury	Invalidity	Survivors	Old-age
Bangladesh	×	▲	×	▲	▲	×	×	×
Cambodia	×	○	○	▲	○	●	●	●
China	○	○	○	○	○	○	○	○
Indonesia	○	▲	▲	▲	○	○	○	○
India	×	○	○	○	○	○	○	○
Myanmar	○	○	○	●	○	●	●	●
Viet Nam	○	○	○	○	○	○	○	○

○ At least one programme anchored in national legislation, including employer-liability programmes based on mandatory risk pooling.

● Legislation not yet entered into force

▲ Limited provision (e.g. Labour code only).

× No provision



THANK YOU