

CONCEPTUAL EVALUATION OF PENSION REFORMS

**Dimitri Vittas
Consultant
World Bank
November 2006**

OUTLINE

- **PROLEGOMENA**
- **CONCEPTUAL FRAMEWORK**
- **APPLICATION TO TURKEY**
- **CONCLUSIONS**

PROLEGOMENA I: PRIMARY PURPOSE

- **THE PRIMARY PURPOSE OF PENSION SYSTEMS IS TO PROVIDE ADEQUATE AND AFFORDABLE AND THEREFORE SUSTAINABLE RETIREMENT BENEFITS.**
- **LABOR MARKET EFFICIENCY AND CAPITAL MARKET DEVELOPMENT ARE DESIRABLE BUT SECONDARY BY-PRODUCTS OF SOUND PENSION REFORMS.**

PROLEGOMENA II: HIGH COMPLEXITY

- **PENSION SYSTEMS ARE HIGHLY COMPLEX WITH FAR-REACHING SOCIAL, ECONOMIC, FINANCIAL AND EVEN POLITICAL IMPLICATIONS.**
- **THEY INVOLVE IMPLICIT OR EXPLICIT LONG-TERM CONTRACTS WITH LARGE INTER-GENERATIONAL TRANSFERS, EITHER THROUGH GOVERNMENT AGENCIES OR THROUGH FINANCIAL MARKETS.**
- **THEY REQUIRE EFFECTIVE REGULATION AND SUPERVISION OVER VERY LONG PERIODS.**

PROLEGOMENA III: TIME-INCONSISTENCY

- **PENSION SYSTEMS ARE TIME-INCONSISTENT, BECAUSE THEY INVOLVE COMPLEX, LONG-TERM CONTRACTS.**
- **EXTERNAL CONDITIONS AND TECHNOLOGY - ECONOMIC, FINANCIAL, SOCIAL AND MEDICAL - ARE ALL LIKELY TO CHANGE DRAMATICALLY OVER LONG PERIODS.**
- **EVEN IF A SYSTEM IS PERFECT FOR CURRENT CONDITIONS, IT WILL BECOME OUT-OF-SYNC IN THE LONG RUN.**

PROLEGOMENA IV: TIME-CONSISTENT WISDOM

- **TA PANTA REI**

- **Irakleitos**

- **PAN METRON ARISTON**

- **Aristotelis**

EVALUATION I: NEED FOR REFORM

- **WHEN BENEFITS ARE INADEQUATE OR UNAFFORDABLE OR BOTH.**
- **BENEFITS ARE INADEQUATE WHEN THEY ARE SMALL OR DO NOT COVER A LARGE SEGMENT OF THE POPULATION.**
- **BENEFITS ARE UNAFFORDABLE WHEN THEY ARE HIGH FOR ALL OR UNDULY GENEROUS FOR MANY.**

EVALUATION II: NEED FOR MIXED PROVISION

- **PUBLIC PILLAR BENEFITS ARE IN GENERAL INDEPENDENT OF THE PERFORMANCE OF FINANCIAL MARKETS.**
- **FUNDED PILLAR BENEFITS ARE BASED ON LONG-TERM CAPITAL ACCUMULATION AND FINANCIAL MARKET PERFORMANCE.**
- **PRIVATE MANAGEMENT OF FUNDED PILLARS IS ESSENTIAL TO REDUCE PUBLIC SECTOR DOMINATION.**

EVALUATION III: SPEED OF REFORM

- **HIGH COMPLEXITY AND TIME INCONSISTENCY SUGGEST GRADUAL REFORM.**
- **LITTLE POINT IN RUSHING TO INTRODUCE A SYSTEM THAT WOULD ITSELF NEED TO BE REFORMED OVER TIME.**
- **RESPECT "REASONABLE" ACQUIRED RIGHTS.**
- **REMOVE MOST EGREGIOUS AND DISTORTIONARY FEATURES.**

EVALUATION IV: PRECONDITIONS FOR REFORM

- **MACROECONOMIC STABILITY, ESPECIALLY LOW INFLATION.**
- **SOUND CORE OF BANKING AND INSURANCE WITH ROBUST REGULATION AND EFFECTIVE SUPERVISION.**
- **STRONG AND DURABLE COMMITMENT.**
- **POLICY REVERSALS AND SETBACKS ARE LIKELY BUT REFORM IS A PROCESS, NOT AN EVENT.**

EVALUATION V: BUILDING BLOCKS OF REFORM

- **INTRODUCE FLAT UNIVERSAL PENSION WITH CLAWBACK PROVISIONS.**
- **LINK RETIREMENT AGE TO LIFE EXPECTANCY.**
- **LOWER ACCRUAL RATES OF PUBLIC PILLAR TO MODERATE LEVELS.**
- **BUILD ROBUST AND EFFECTIVE FRAMEWORK FOR PRIVATE PROVISION.**

TURKEY I: PAST PROBLEMS

- **LARGE DEFICIT RELATIVE TO NATIONAL INCOME.**
- **VERY HIGH INFLATION**
- **EARLY RETIREMENT AT YOUNG AGES. LONGEST LIFE IN RETIREMENT.**
- **VERY HIGH ACCRUAL RATES IN SOME CASES.**
- **LIMITED COVERAGE.**

TURKEY II: MACROECONOMIC REFORMS

- **LOW (SINGLE-DIGIT) INFLATION.**
- **REDUCTION OF PUBLIC SPENDING.**
- **PRIVATIZATION PROGRAM.**
- **REFORMED AND STRENGTHENED BANKING SYSTEM.**
- **RESTRUCTURING OF INSURANCE SECTOR.**

TURKEY III: GRADUAL PENSION REFORM

- **REMOVAL OF EARLY RETIREMENT OPTIONS.**
- **GRADUAL INCREASE IN RETIREMENT AGE.**
- **LOWERING OF ACCRUAL RATES.**
- **UNIFICATION OF SOCIAL SECURITY SCHEMES.**
- **RESPECT FOR "REASONABLE" ACQUIRED RIGHTS.**
- **LONG-TERM IMPLEMENTATION PLAN.**
- **PENDING CHALLENGE IN CONSTITUTIONAL COURT.**

TURKEY IV: ROBUST PRIVATE PILLAR

- **CREATION OF NEW VOLUNTARY PRIVATE PILLAR.**
- **ROBUST REGULATORY FRAMEWORK.**
- **STRICT LICENSING, ASSET SEGREGATION, SAFE CUSTODY RULES.**
- **LIMITS ON ACCOUNT AND FUND SWITCHING.**
- **CAPS ON OPERATING FEES.**
- **EFFECTIVE MONITORING AND SUPERVISION.**
- **HIGH TRANSPARENCY AND TIMELY DISCLOSURE OF INFORMATION.**

TURKEY V: REMAINING STEPS

- **LINK RETIREMENT TO LIFE EXPECTANCY.**
- **CONTAIN FINANCIAL COST OF PUBLIC PILLAR.**
- **EXPAND COVERAGE THROUGH MODEST UNIVERSAL PENSION.**
- **LOWER OPERATING CAPS AND EXPAND INTERNATIONAL ASSET DIVERSIFICATION.**
- **REGULATE AND PROMOTE ANNUITY MARKET.**
- **PRESERVE EFFECTIVE MONITORING.**
- **KEEP INFLATION UNDER CONTROL.**

CONCLUSIONS

- **GOOD START IN REFORMING A COMPLEX AND DEMANDING AREA.**
- **NEED FOR STRONG AND DURABLE COMMITMENT.**
- **MAINTAIN MACROECONOMIC STABILITY.**
- **ENSURE EFFECTIVE REGULATION AND SUPERVISION.**
- **PROMOTE SOCIAL EQUITY.**