CONCEPTUAL EVALUATION OF PENSION REFORMS

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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.