SEPTEMBER 2005

Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

A View from the Bank

The World Bank has recently published a report *Old-Age Income Support in the Twenty-first Century: An International Perspective on Pension Systems and Reform*. This edition of *Commentary* is devoted to a summary of the highlights of the World Bank report and includes several direct quotes from the report. The purpose of the report is to clarify and update the World Bank's perspective on pension reform; it is intended to conceptualize and explain current policy thinking within the Bank and communicate to the international public the Bank's framework for pension reform and, more specifically, to provide a guide to the criteria and standards that the Bank will apply in providing financial support for development projects that include an element of pension reform. The World Bank states its goals in terms of broad social protection, poverty alleviation and consumption smoothing. To achieve the goals with respect to pension provision, the Bank proposes a multipillar system comprised of some combination from among five basic elements: (a) a noncontributory (zero pillar) demogrant or social pension; (b) a contributory system (first pillar) linked to earnings to replace a portion of income; (c) a mandatory system (second pillar) comprising an individual savings account; (d) a voluntary system (third pillar), flexible and discretionary in nature, comprising either individual or employer-sponsored defined benefit or defined contribution arrangements; and (e) informal intrafamily or intergenerational sources of support, both financial and non-financial.

In an earlier 1994 report *Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth* the World Bank advocated a narrower three-pillar approach and actively promoted the perceived advantages of the second pillar mandatory system of individual savings accounts. The new report reflects on the experience of the Bank over the last decade and acknowledges five main additions to the Bank's perspective: (a) a better understanding of reform needs and measures; (b) the extension of the multipillar model beyond the three-pillar structure to encompass as many as five pillars and to move beyond the conventional concentration on the first and second pillars; (c) an appreciation of the diversity of effective approaches, including the number of pillars, the appropriate balance among the various pillars and the way in which each pillar is formulated in response to particular circumstances or needs; (d) a better understanding of the importance of initial conditions in establishing the potential for and limitations within which reforms are feasible; and (e) a strong interest in, and support of, country-led innovations in pension design and implementation.

The Bank's view incorporates several principles that are deemed essential to any successful reform: (a) all pension systems should have elements that provide basic income security and poverty alleviation across the full breadth of the income distribution; (b) prefunding for future pension commitments is advantageous for both economic and political reasons; and (c) in countries where prefunding promises to be beneficial, a mandated and fully funded second pillar provides a useful benchmark against which the design of a reform should be evaluated. The World Bank specifies certain goals and criteria for this purpose in stating that the primary goals of a pension system should be to provide adequate, affordable, sustainable and robust retirement income while seeking to implement welfare-improving programs in a manner appropriate to an individual country. The Bank's mission is to achieve economic and social development goals in client countries around the world; it emphasizes that the design of a pension system or its reform must explicitly recognize that pension benefits are claims against future economic output and, to fulfill their primary goals, pension systems must contribute to future economic output; reforms should be designed and implemented in a manner that supports growth and development and diminishes possible distortions in capital and labor markets.

A demographic study of the geographic distribution of the world's elderly population discloses that approximately 60 percent of the world's elderly live in the less developed countries and that this measure is projected to increase to around 80 percent by 2050. The 1994 World Bank report had a focus on the first, second and third pillars and it advocated an increasing role for the second pillar as a means of providing financial security in old-age through individual savings accounts. Over the last decade since the publishing of the earlier report, pension reforms based on the second pillar have been implemented in Latin America and in the transition economies of the post Soviet Union era in Eastern and Central Europe.

The 2005 World Bank report extends the three-pillar concept to as many as five pillars and includes the zero pillar tax-financed safety net or demogrant; this new pillar will serve to address concerns that reforms have not succeeded in increasing the extent of pension coverage for the world's labor force and will embrace the needs of the lifetime poor.

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