Konrad Adenauer Stiftung

iima

EU-ASIA Economic Governance Forum 2014

The Price of Social Security or Social Security at all Costs?

Current Trends in Pension Provision

Contents

Most countries both in Asia as well as in Europe are facing mounting challenges in maintaining their social security systems. Due to rapidly aging societies, the industrialized countries, among them Germany and Japan, are confronted with increasing expenditures for public and private pension provision. India, on the other hand, has yet to calibrate a private pension market which is set to grow exponentially, while Poland and some other countries in Eastern Europe seem to bid farewell to the idea of private pension funds.

Distinguished experts from these four countries have followed our invitation and will introduce some of the latest trends and plans for reform of the respective pension systems. Afterwards they will join a panel to discuss possible benefits and challenges of those different paths.

India

Compared to other emerging economies like Indonesia and Brazil, India has been a latecomer when it comes to pension funds. Since 2004, all Indian states except two have introduced a benefit scheme for government employees. Just as recently as 2009, the National Pension System (NPS) has been opened for all citizens. Due to India's young population and growing labour force, the future impact of the pension provision is huge! Already by 2015, the NPS assets are expected to grow to $175 billion. Among private investors, the adoption of the benefit scheme has been rather hesitant, though. The latest pension bill of 2013 is supposed to change that. According to the new law, Indian workers can deposit money with private pension funds. It also allows foreign investment of up to 26 per cent in the untapped Indian pension market. The latest changes strongly indicate a shift from a defined benefit (NPS) to a defined contribution structure with all associated risks and uncertainties. Against this background, the question of social welfare figures prominently on the political agenda for the upcoming general elections in India (April/May 2014).

Poland

Compared to India, Poland seems to walk exactly in the opposite direction. After the end of communism, the country embraced the benefits of capital markets also for its pension scheme. At the end of the nineties, the government in Warsaw, as well as some other Eastern European countries, shaped its old-age plan according to the retirement system in Chile. Workers pay social security taxes from their salaries and the government diverts a certain portion of the money into private pension funds which invest it in stocks and bonds. Unfortunately, the system did not foresee the actual demographic changes in Poland. Apart from that, it was based on the notion of booming global stock markets. Instead, asset prices plummeted due to the financial crisis. Combined with growing expenditures for an aging society, the private funds created a large hole in pension provision. It had to be filled by the Polish govern-

ment which led to an excessive build-up of public dept during the recent years. At the beginning of February 2014, the government in Warsaw reversed its pension scheme and seized $50 billion of privately run pension funds. The money is transferred back into state control.

Japan

Based on the experiences in Poland and the widespread disappointment within the Polish society about the investment returns and management fees of private pension funds, Japan seems to take a rather courageous step. According to an advisory panel to the government in Tokyo, the Japanese pension fund GPIF should become more diversified. So far, GPIF, the biggest pension fund worldwide, has close to 80 per cent of its assets in Japan. Apart from that and unlike Australia, the US, UK or Canada, Japan's retirement assets are dominated by bonds and not by equities. Due to the country's monetary easing, the yields of local government bonds are, however, abnormally low. Since the Japanese society is aging faster than in any other country worldwide, GPIF will not be able to meet its long-term liabilities without higher returns. Hence, the pension fund is expected to increase its global investment and to also envisage a growing amount of riskier assets, among them stocks.

Germany

Due to a different retirement plan, pension assets (bonds and equities) in Germany amount to only 14 per cent of GDP (2013e) compared to 65 per cent in Japan. Private insurances for pension provision have been promoted during the last two decades. To a large extent, the old-age scheme still relies on Germany's public pension fund, however. As in Japan, though, the German society is aging rapidly. Between 1960 and 2009, the average period that a pension is drawn has nearly doubled from close to 10 years to more than 18 years. The public pension provision accounts to nearly 30 per cent of Germany's federal budget. In order to cope with increasing expenditures for social welfare, the government in Berlin started to gradually raise the retirement age from 65 (until 2012) to 67 (by 2029). According to a new pension plan which was proposed in January 2014, employees who have contributed to the social security sys-tem for at least 45 years will, however, be able to already retire at the age of 63. The draft bill also allows higher pensions for mothers whose children were born before 1992. Critics warn that the latest proposal will cost more than $80 billion until 2020.