CLOSING THE COVERAGE GAP

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Pension Core Course
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Different types of coverage gaps

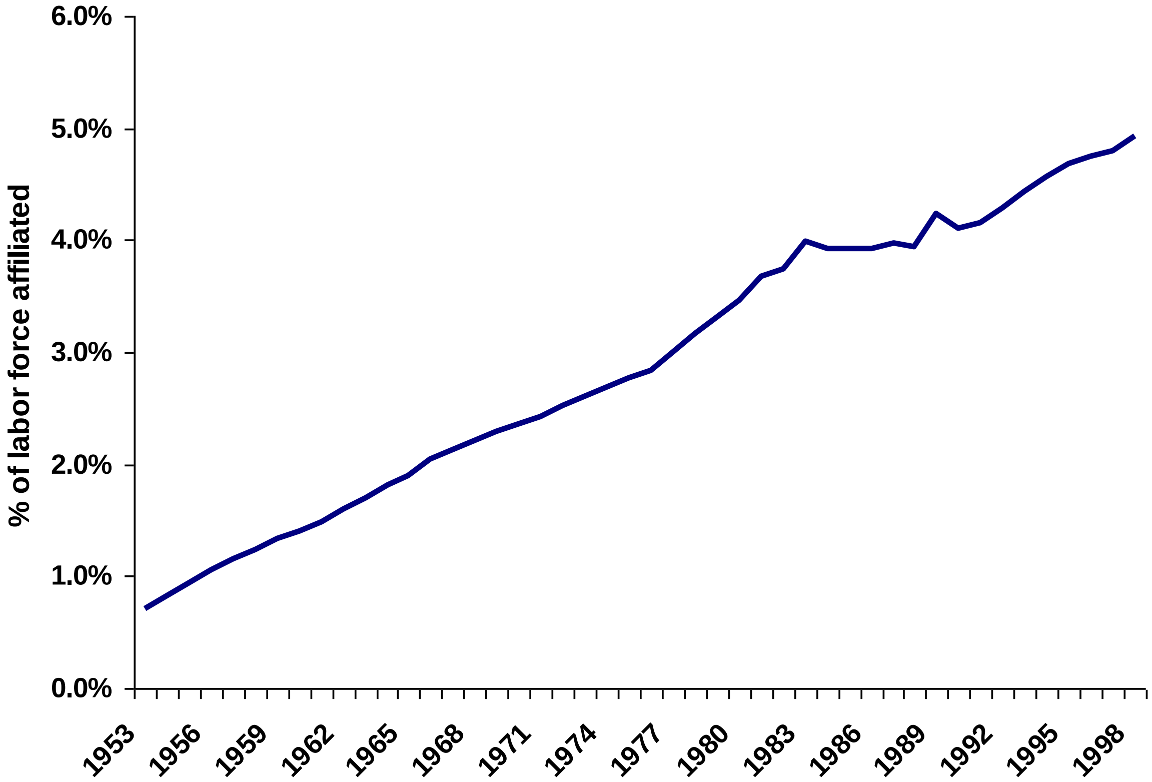
- In a subset of richer countries, the main kind of gap is related to adequacy rather than coverage and this is being exacerbated by reforms that reduce benefits in OECD countries; the solution proposed is to expand voluntary, private pension coverage
- In poor and middle income countries, most workers are either not participating (including in the mandated pension scheme and those that are have low contribution densities (esp. low income workers)

Contributors to mandated schemes

Country types	PPP$YCAP	Coverage ratio	Ratio 20-59/60+ population
LIC	>4500	17%	7.6
MIC	4500-15,000	51%	6.3
HIC	15,000+	90%	3.4
TSE	2000-20,000	66%	3.7

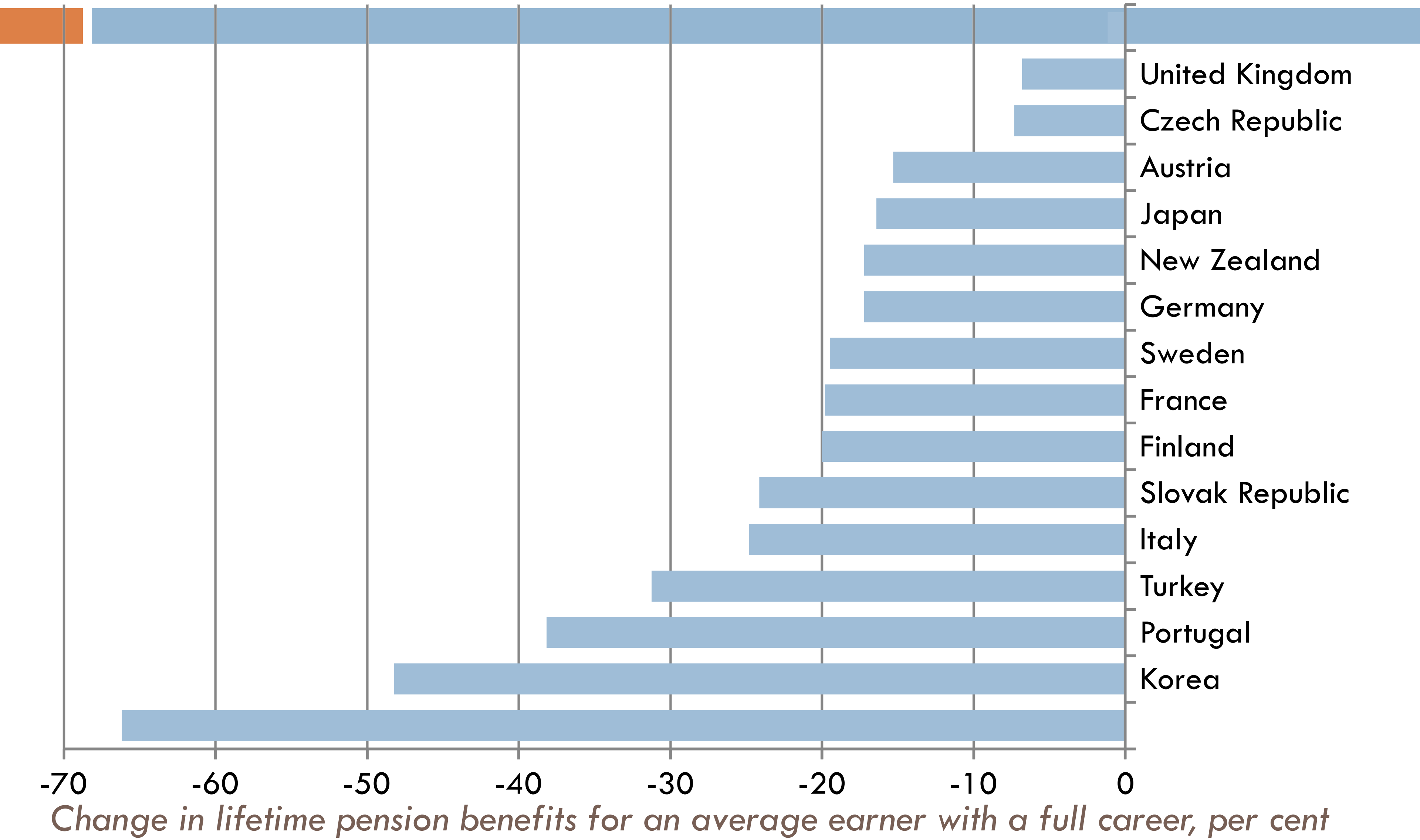
Very little progress over time…

Pension coverage in India, 1953-1998



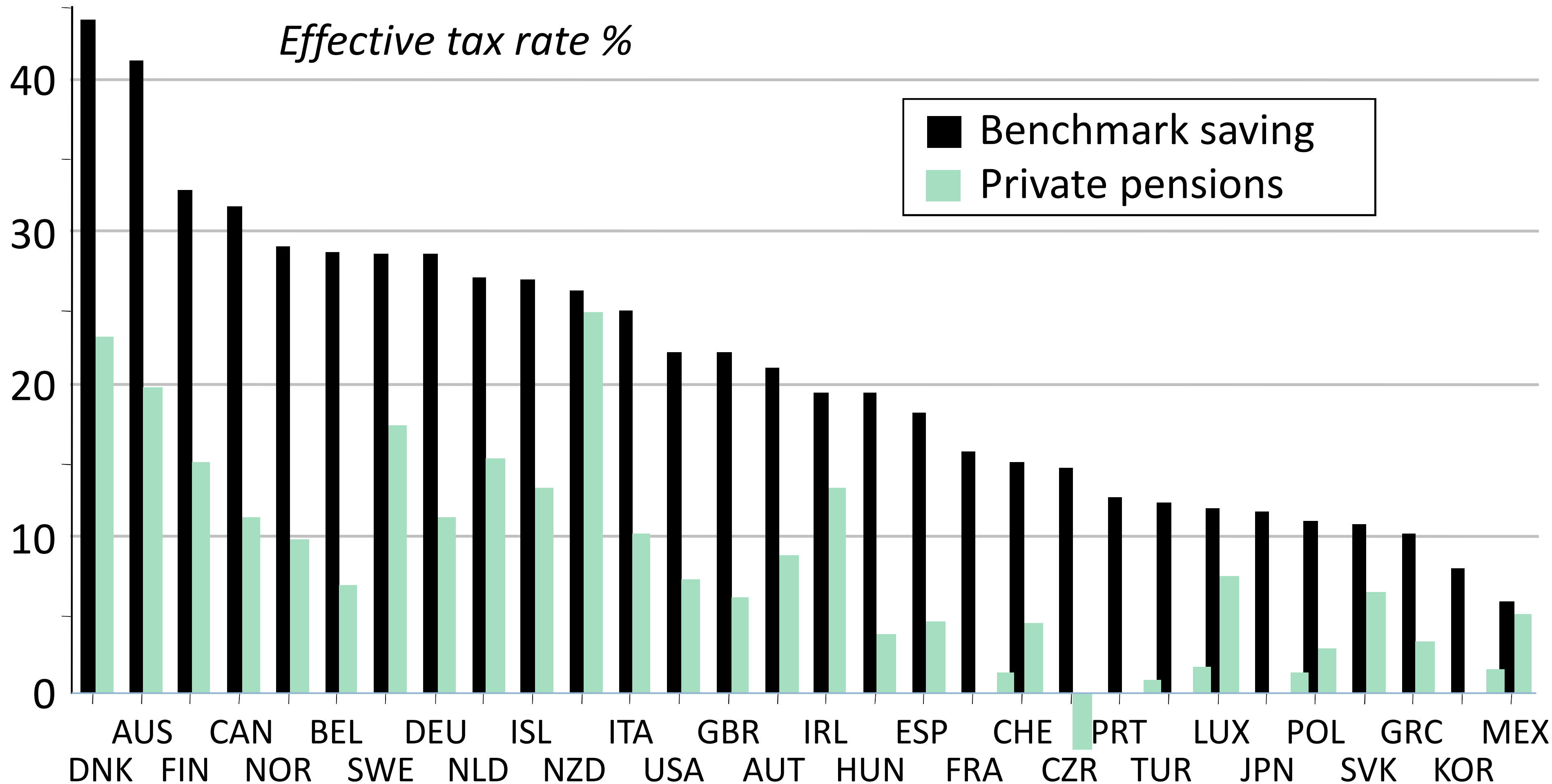
RICHER COUNTRIES

Impact of reforms on lifetime benefits



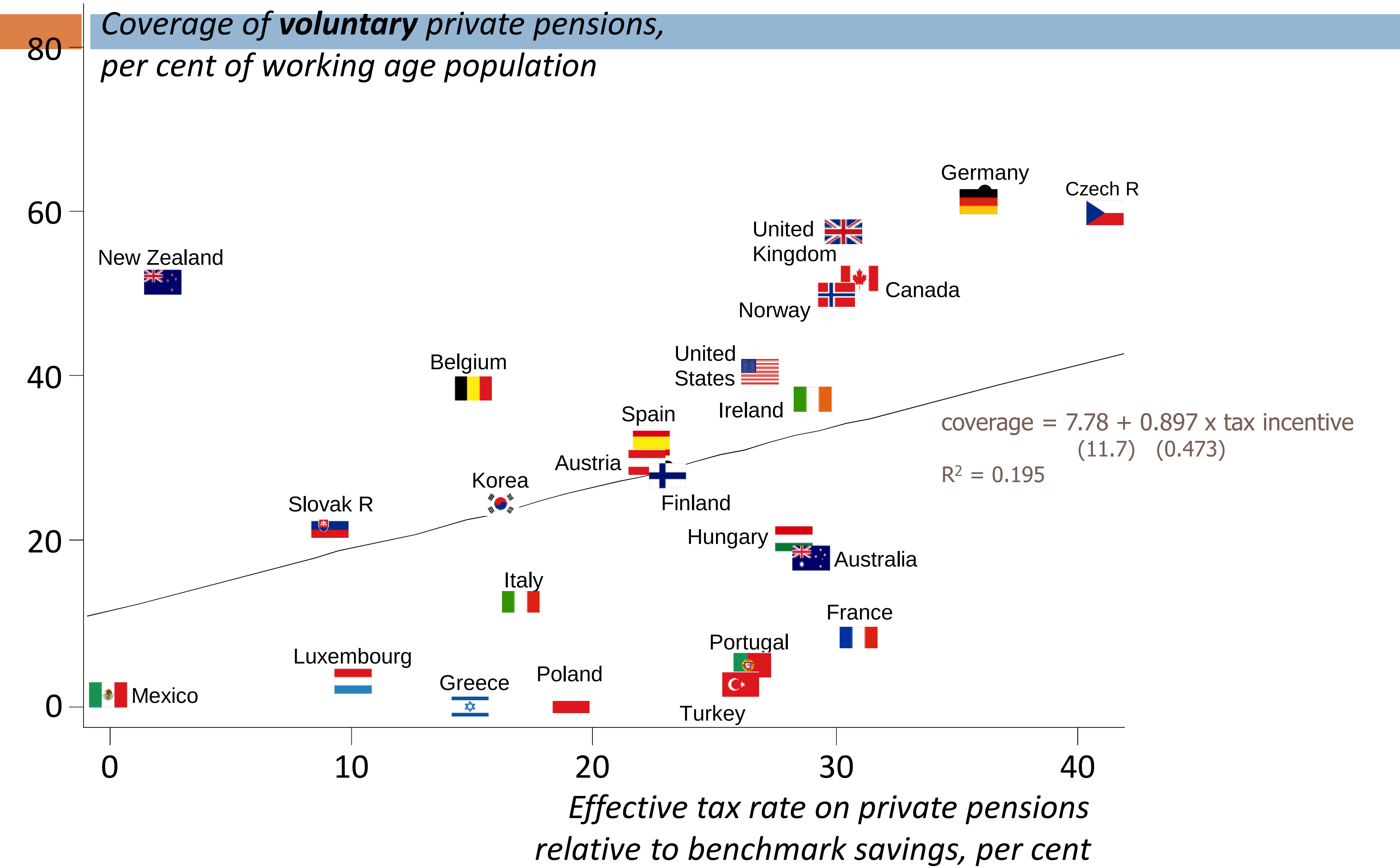
Source: Apex models

Tax treatment of savings

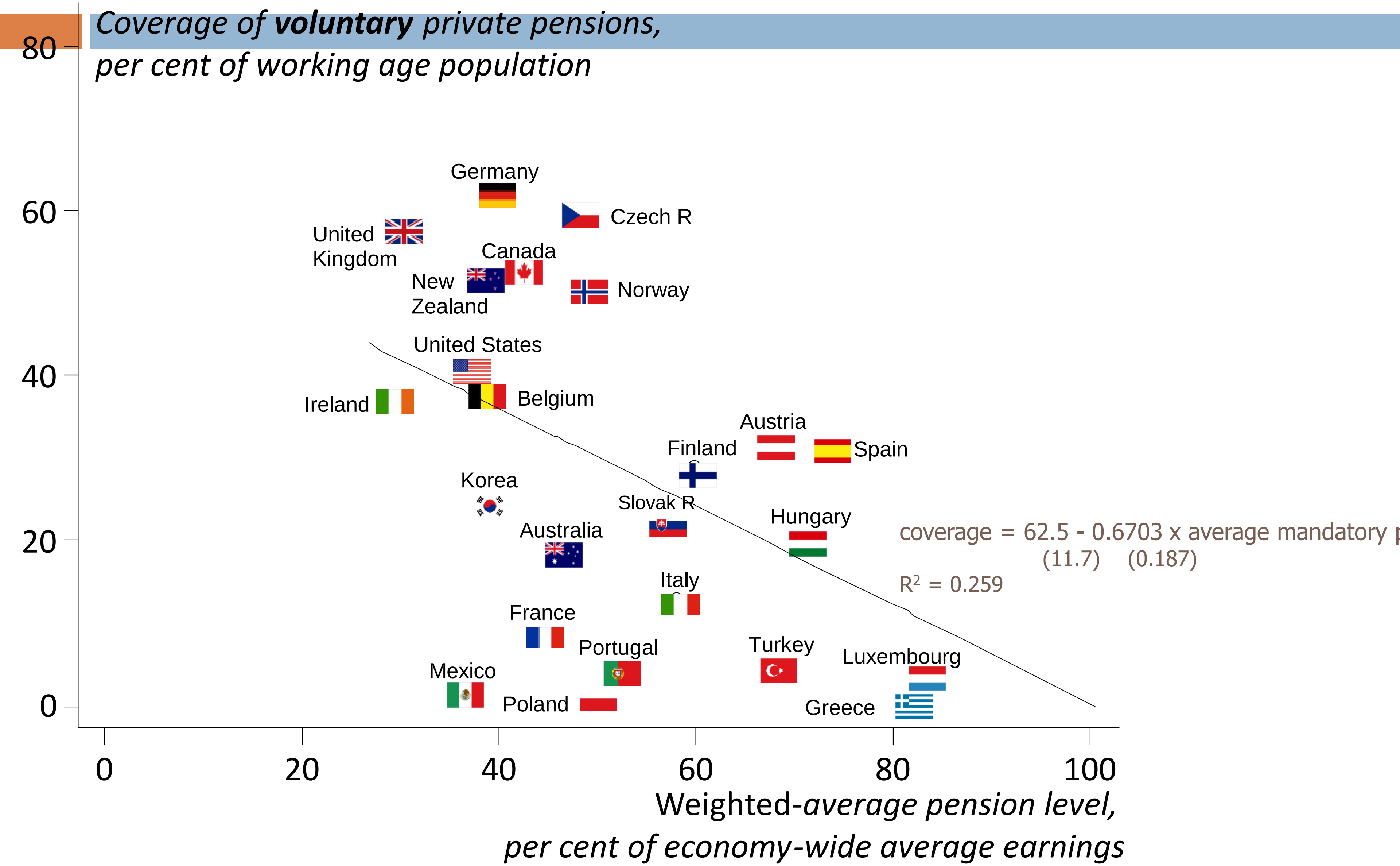


Source: Yoo, K.Y. and de A. Serres (2004), "Tax treatment of private pension savings in OECD countries", *OECD Economic Studies*, vol. 39, no. 2, pp. 73-110.

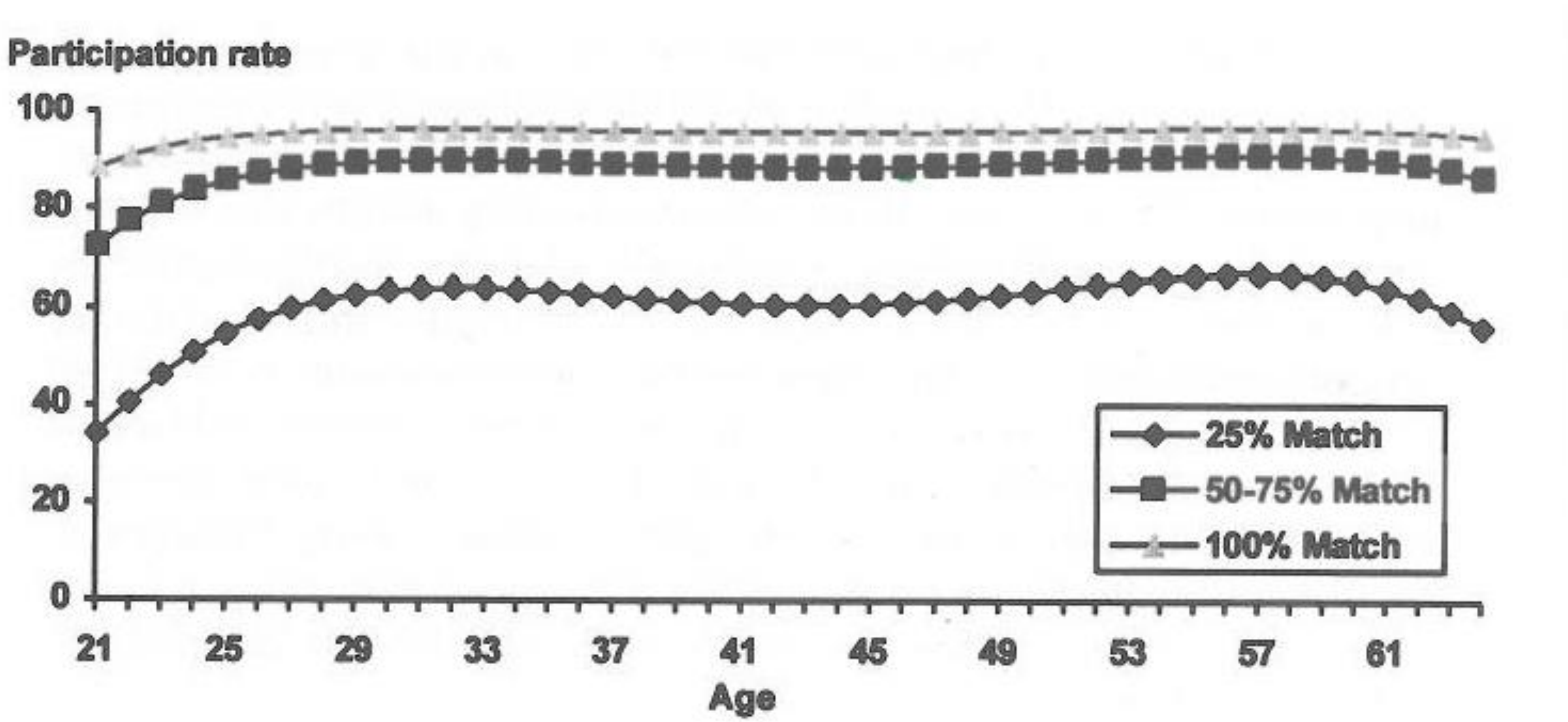
Taxes and coverage



Mandates and coverage

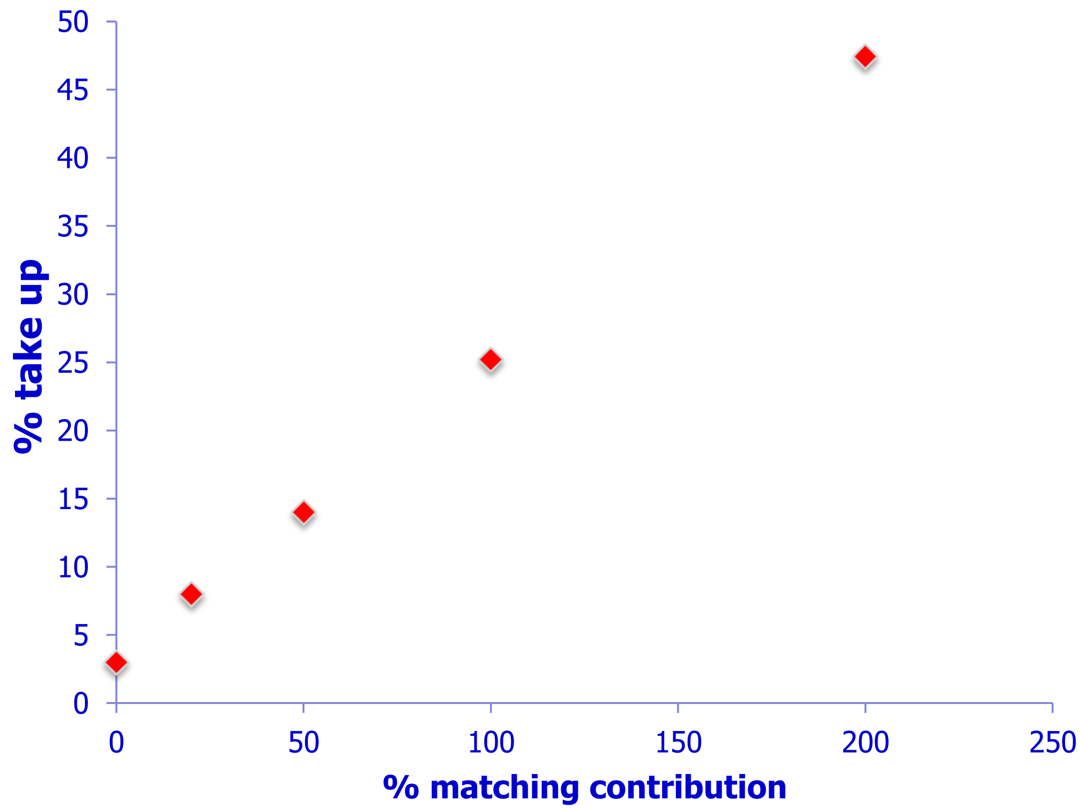


Matching contributions: the case of the US



Matching contributions: the case of the US

Duflo et. al. (2005) tested the take up elasticity for US low income workers, but similar studies have not been done for developing countries

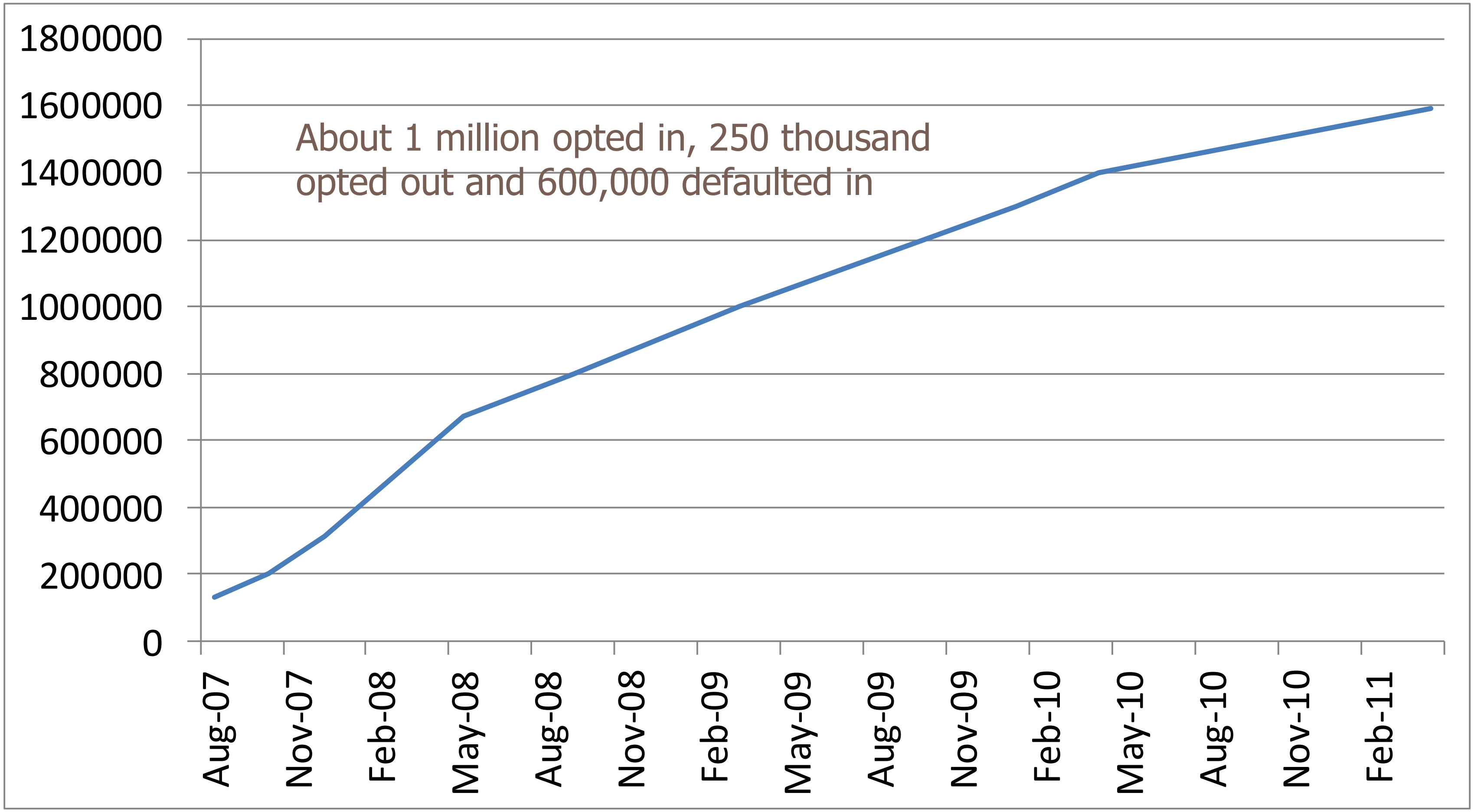


Matching contributions: the case of New Zealand

- KiwiSaver has a range of membership incentives including:
- **$1,000 kick-start** : The Government “kick-starts” accounts with a tax-free contribution of $1,000.
- **Member tax credit:** The Government matches individual contributions by up to $1,042.86 each year ($20 a week).
- **Compulsory employer contributions:** If eligible, employers also contribute an amount equal to 2% of pay to KiwiSaver savings.
- **Savings withdrawal for first home:** Some or all of KiwiSaver savings can be put towards buying a first home.
- **First home deposit subsidy:** After 3 years of contributing to KiwiSaver, contributors may be entitled to a first home deposit subsidy (up to $10,000 for a couple)
- *New employees who have been automatically enrolled can choose to opt- out of KiwiSaver between two and eight weeks after being automatically enrolled; default fund and portfolio (conservative)*

Outcomes of KiwiSaver

Number of persons signed up to the scheme, 2007-2011



Some lessons

- There is evidence that incentives through matching can increase coverage, but less clear what is the optimal match
- Defaults or auto-enrolment has been shown to produce strong results (other examples include the new UK scheme and Denmark)
- Implementation is facilitated for richer countries by good information on individuals, especially through income tax system

LOW AND MIDDLE INCOME COUNTRIES

Challenges are very different

- Supply side
  - Institutions and providers may be much less experienced or not exist at all
  - Credibility may not be high enough to inspire confidence
  - Basic infrastructure such as robust forms of identification may be lacking
  - Vast majority of population not captured by the income tax information system

Demand side

- Variable and seasonal income flows
- Low savings capacity
- Low exposure to formal financial sector
- Transient career path (rural-urban migrants)
- High degree of self-insurance (i.e., lack of various types of insurance coverage)
- High discount rate/liquidity preference
- Higher mortality/morbidity (relative to covered)

Strategies for system design

- Minimize transaction costs
  - Allow small and variable contribution amounts and flexible timing
  - Harness existing groups where possible
  - Use IT to lower transaction costs on front end (banking correspondents, mobile payments)
  - Use formal pension system infrastructure where feasible
  - Simple investment types, reliance on defaults
- Effective outreach
  - Credible institutions must participate on provider side
  - Pull factor may require paying providers’ incentives for enrolment (especially at outset)

Examples

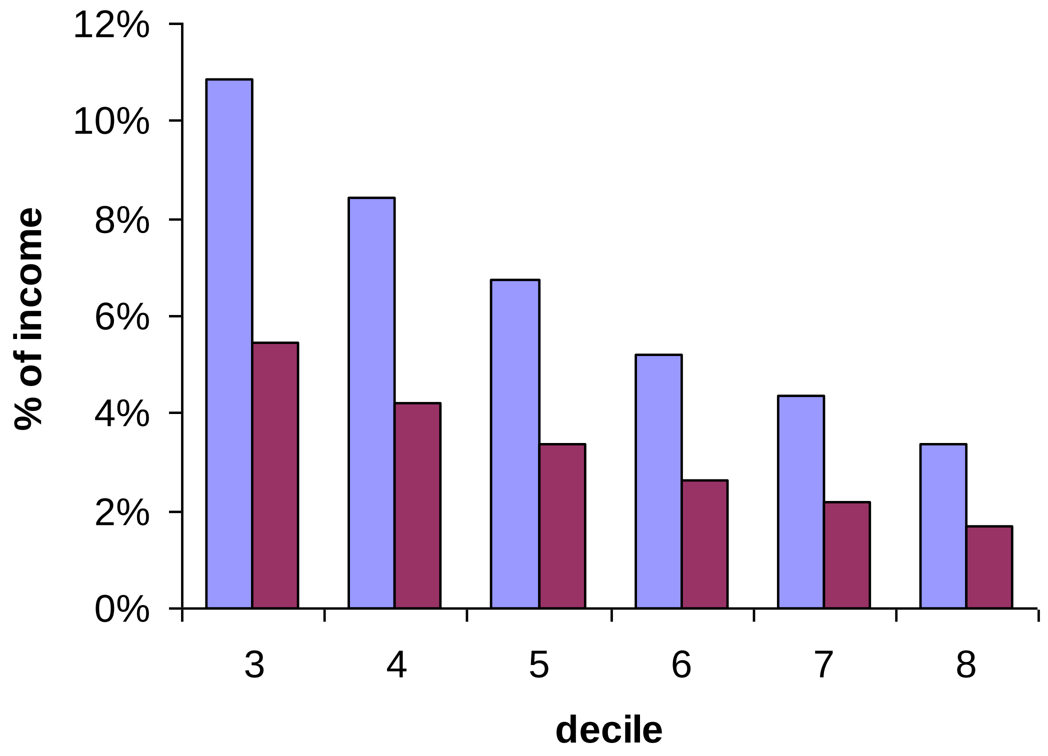
- Kenya: The Mbao Pension Plan is specifically aimed at the informal sector with contributions made via mobile phone money and is flexible subject to a certain minimum contribution over the course of the year
- Ghana: informal sector pension scheme allows variable contribution levels and flexible timing for making contributions

Strategies for system design

- Affordability and incentives
  - Affordable contribution levels
  - Link with health/disability insurance where feasible
  - Voluntary pensions in rich countries exist due to tax treatment, but irrelevant for informal sector workers – a substantial matching contribution is needed to overcome high discount rate and liquidity preference
- Age of withdrawal must be in line with realistic biological deterioration

How affordable is the MDC to workers?

Example: Based on a target benefit just above the Indian poverty line, the contribution required with a 1:1 match is 5% of income for decile 3

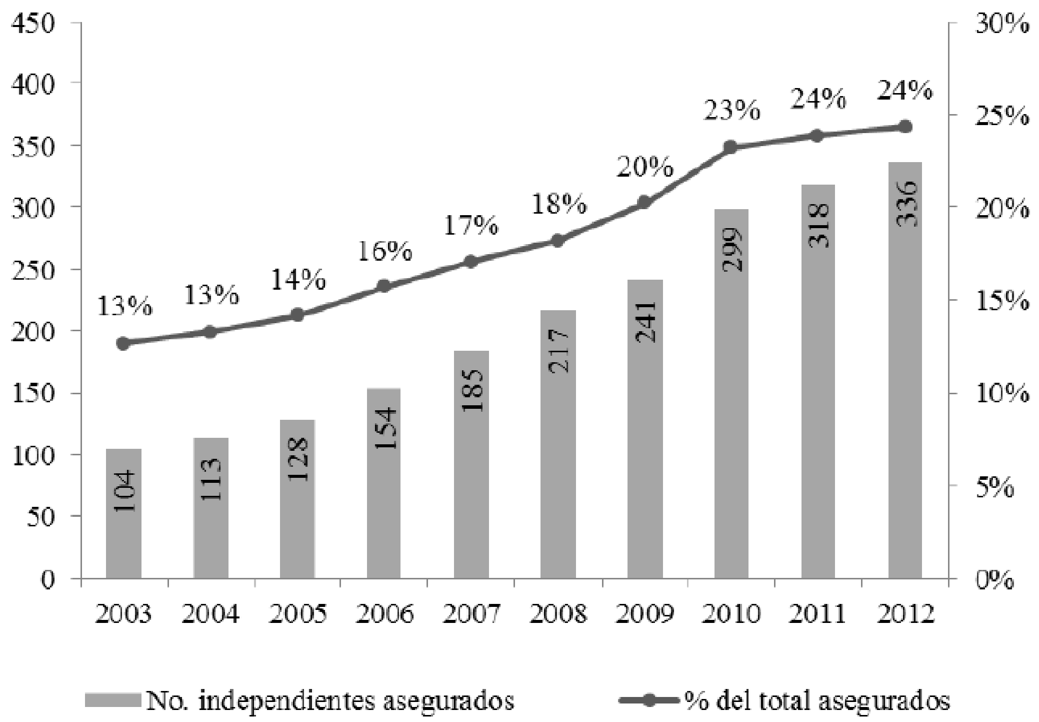


Some examples

- Turkey introduced a match of up to 25% of minimum wage in January 2013
- Thailand has recently introduced a 1:2 match for the self employed which pays a lump sum
- India matches 1:1 up to a low flat amount for informal sector workers
- China recently introduced new rural pension which matches contributions up to a low flat amount at 30:100 and offers a non-contributory pension for elderly parents of contributors
- Costa Rica since early 2000s pays 27% of the contributions for self-employed workers with less than 2x the minimum wage with lower shares as incomes rise

Take up: Costa Rica

Significant increase in coverage of self employed



Source: IDB (2013)

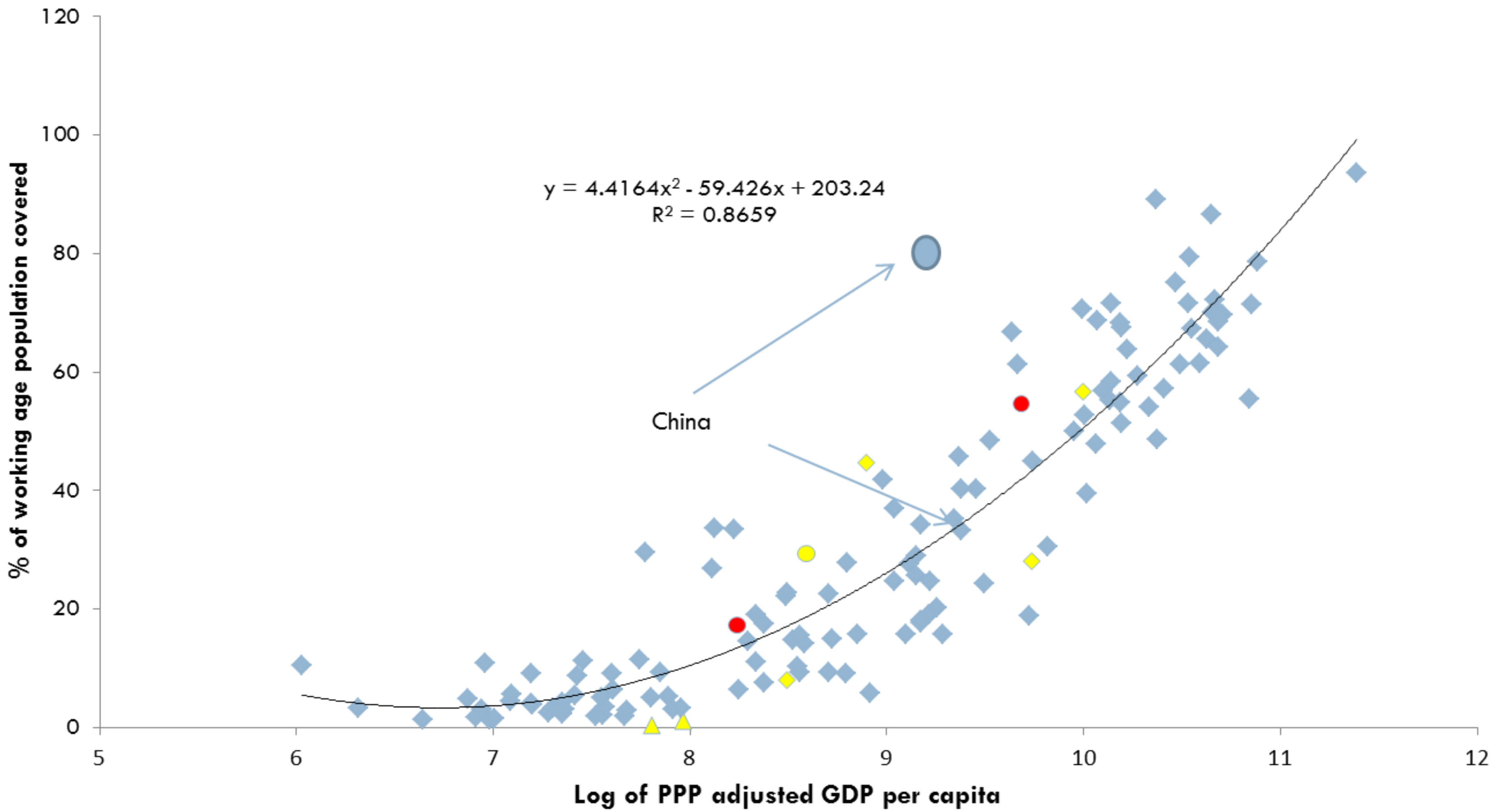
Take up: India

- Fewer than 1 million people have joined and evidence is that about half do not contribute regularly, why?
  - Information campaign has been passive and not tailored to the masses (TV, newspaper, mostly english)
  - Large share have no interaction with formal financial sector
  - Lack of incentives for providers (banks, asset managers)
  - May cannot meet KYC norms, lack identification
- "Aggregators" such as MFIs have been licensed but they generally deal only with their own members

Early evidence on demand side

- Data from one aggregator, an NGO focusing on financial inclusion in limited geographic areas provides early evidence on demand side factors
  - Local staff provide information on NPS-lite, match
  - Enrolment process made simple and low cost
  - Trusted entity
- Take-up is around 5-10% of eligible population
  - Although not representative sample, initial results show that women are far more likely to join; income positively correlated; married more likely; landholders less likely; high correlation with insurance coverage;

Take up: China



Considering the parameters for matching

- Rough estimate of MDC cost
  - Set target pension at 40% YCAP
  - Calculate required total contribution for full career 10% of YCAP
  - Set match at 1:1 (5% of YCAP from government)
  - With labor force/population (40%)* share in informal sector (80%) * take up (50%) = 0.8% of GDP
- This can be reduced to 0.4% of GDP if targeted to the bottom half of the informal sector; (this yields a 40% increase in coverage or 8 percentage points)
- Match can be reduced subject to fiscal constraints

MDCs and social pensions

- MDCs take a long time to mature and have no impact on old age poverty; it does nothing for the current or soon to be old
- MDC policy and social pensions can be linked and harmonized to achieve clear objectives over time
- Social pension dependence will be greater for older workers and gradually be replaced by dependence of younger workers on MDCs
- SP can be set at absolute poverty level and indexed to inflation while MDC parameters linked to YCAP; prefunding as population ages
  - Set target pension at 40% YCAP
  - Calculate required total contribution for full career 10% of YCAP
  - Set match at 1:1 (5% of YCAP from government)
  - With labor force/population (40%)* share in informal sector (80%) * take up (50%) = 0.8% of GDP
- This can be reduced to 0.4% of GDP if targeted to the bottom half of the informal sector; in this case, coverage would be doubled
- Match can be reduced subject to fiscal constraints

Concluding thoughts

- Tax incentives are not relevant in most developing countries
- Matching contributions are being considered or started in a number of countries with low coverage
- Matching contribution policies alone do not address the current coverage gap – social pensions can play that role in the short run until MDC matures
- Careful analysis of fiscal tradeoffs between the two types of program can only be done with long term projections and studies of take up elasticity
- It may be especially attractive in countries with DC schemes for formal sector workers to reduce start up costs and allow for a seamless system