

# CLOSING THE COVERAGE GAP

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Pension Core Course  
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# Different types of coverage gaps

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- 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

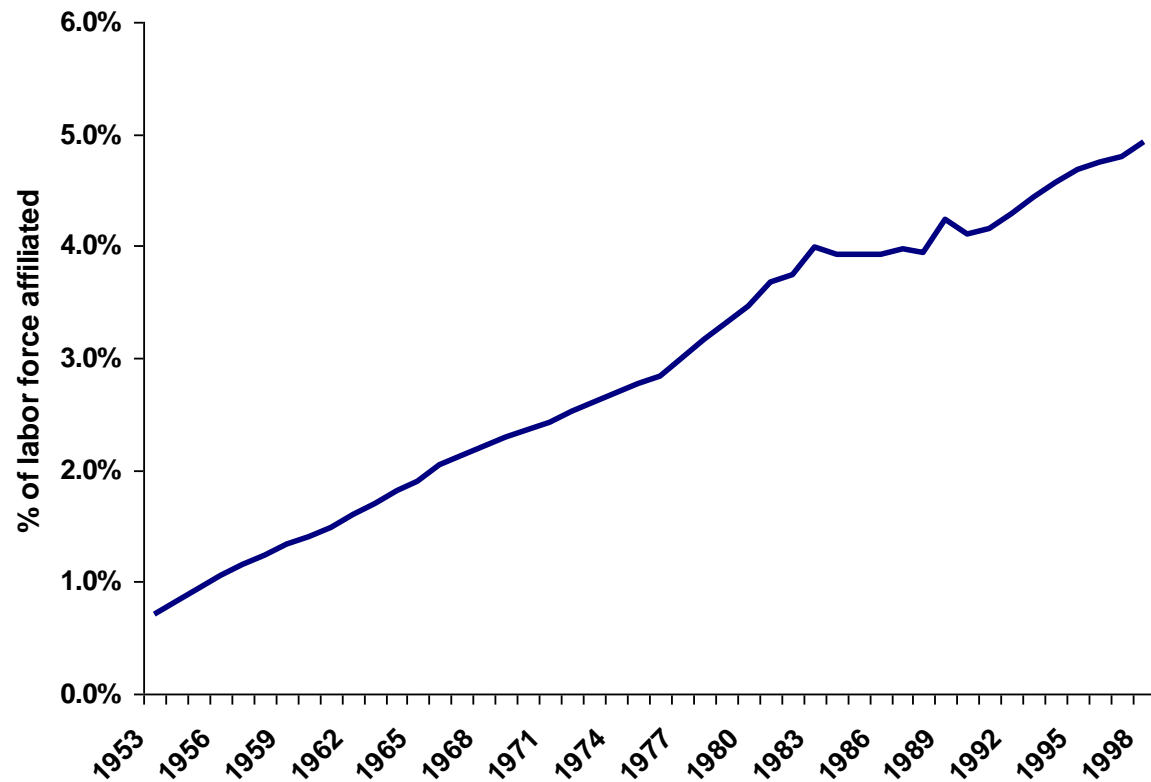
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Country types	PPP\$YCAP	Coverage ratio	Ratio 20-59/60+ population
LIC	>4500	17%	7.6
MIC	4500-15,000	51%	6.3
HIC	15,000+	90%	3.4
TSE	2000-20,000	66%	3.7

# Very little progress over time...

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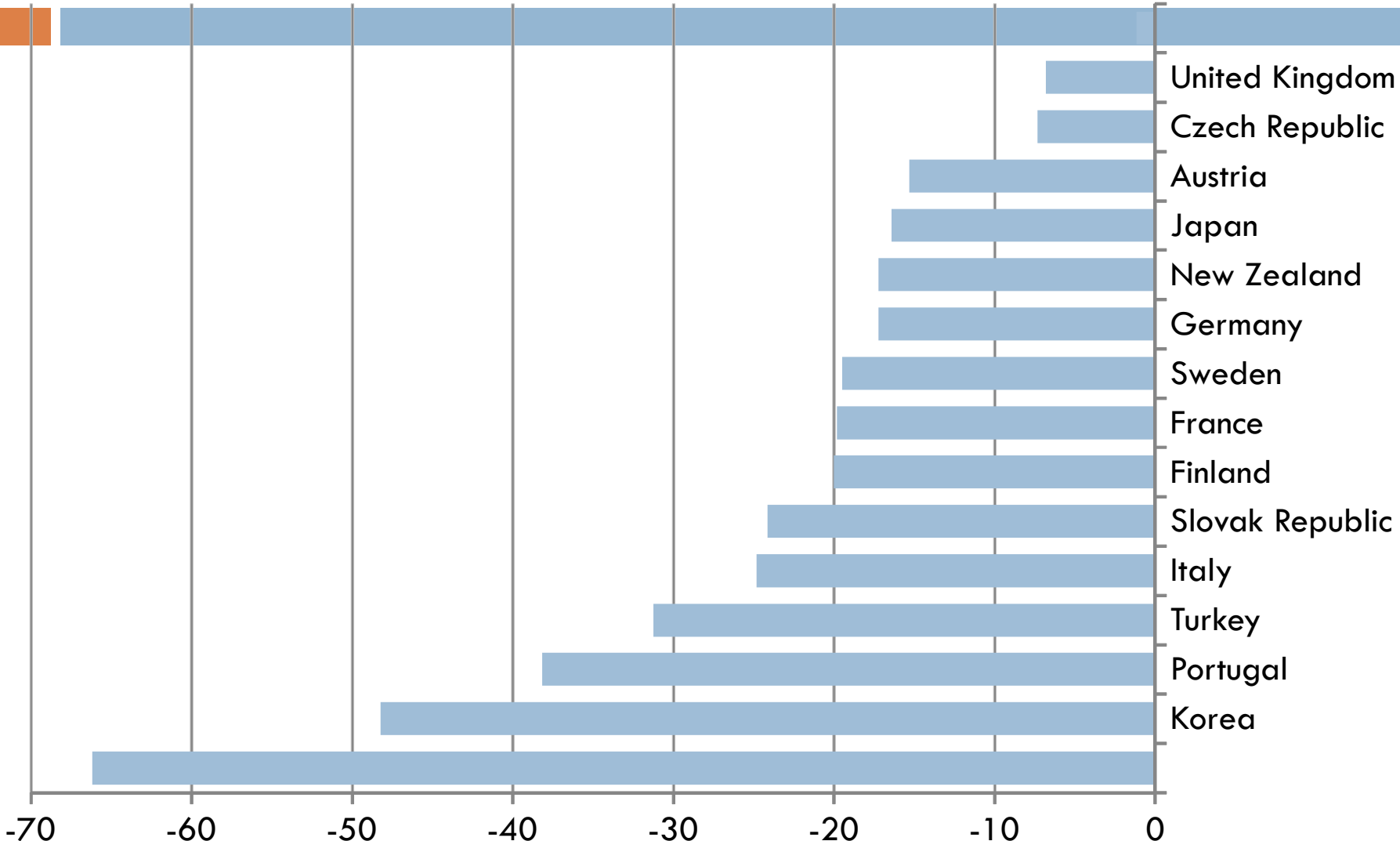
Pension coverage in India, 1953-1998



# RICHER COUNTRIES



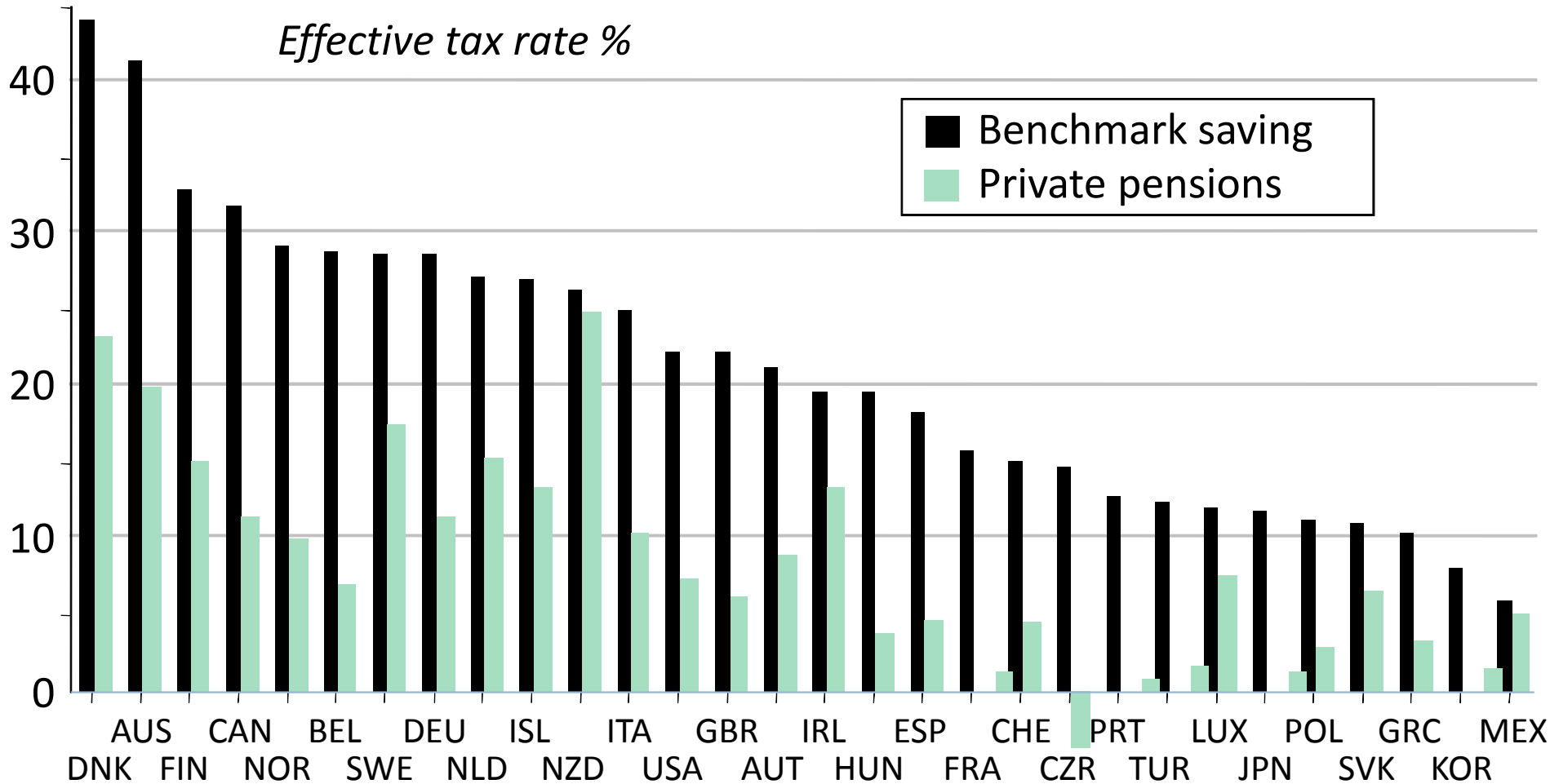
# Impact of reforms on lifetime benefits



*Change in lifetime pension benefits for an average earner with a full career, per cent*

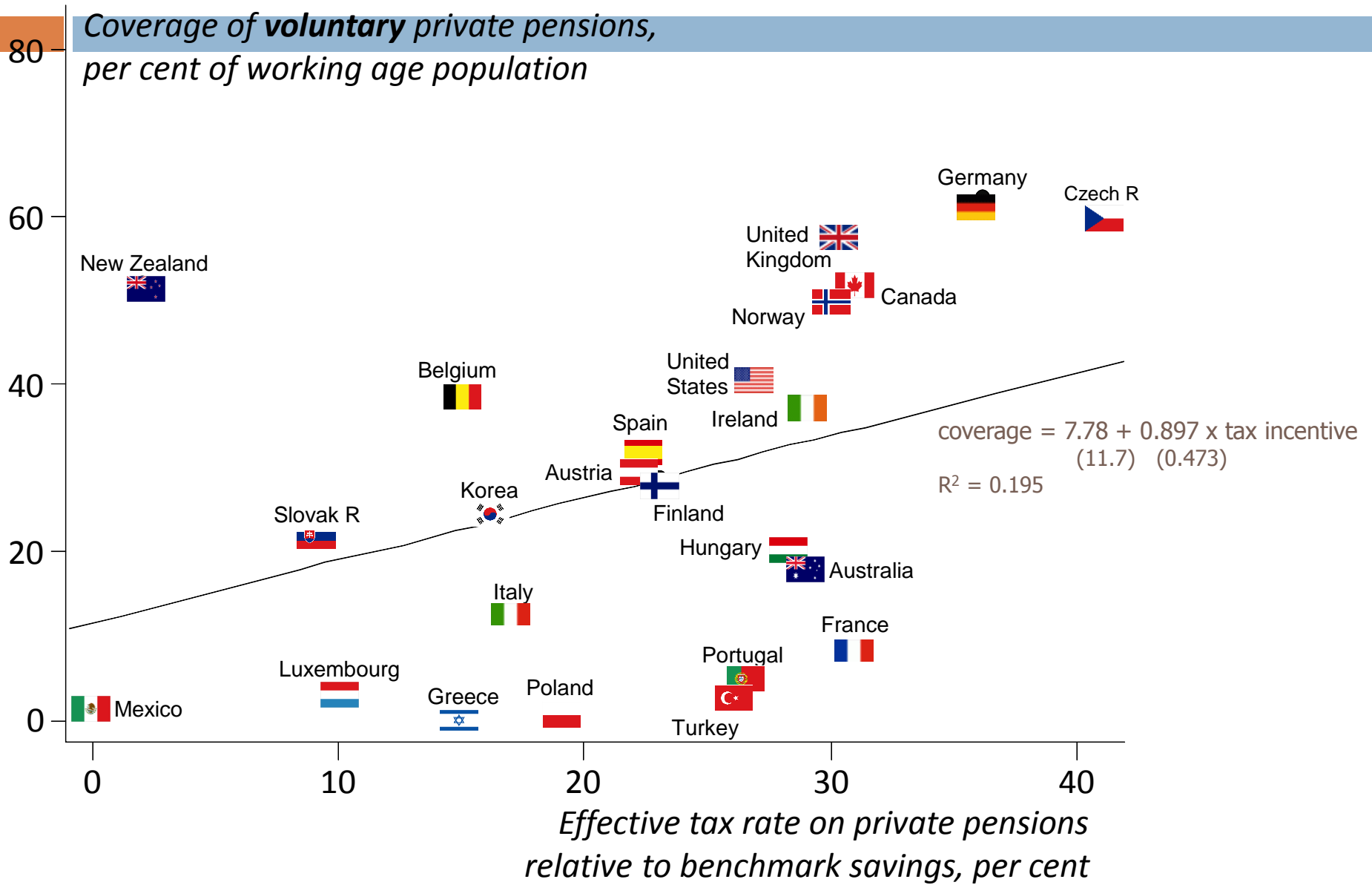
Source: Apex models

# Tax treatment of savings



# Taxes and coverage

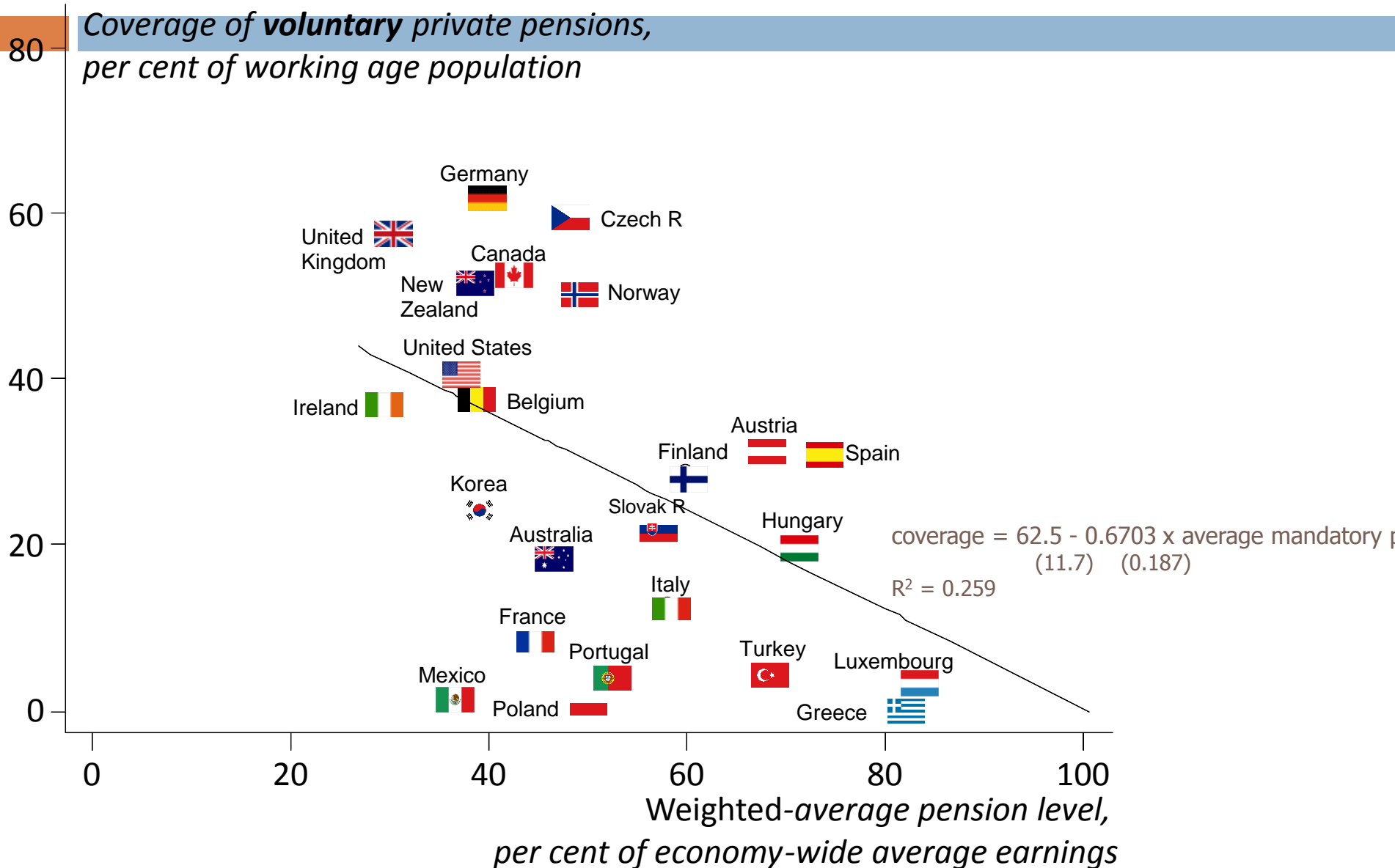
Coverage of **voluntary** private pensions,  
per cent of working age population





# Mandates and coverage

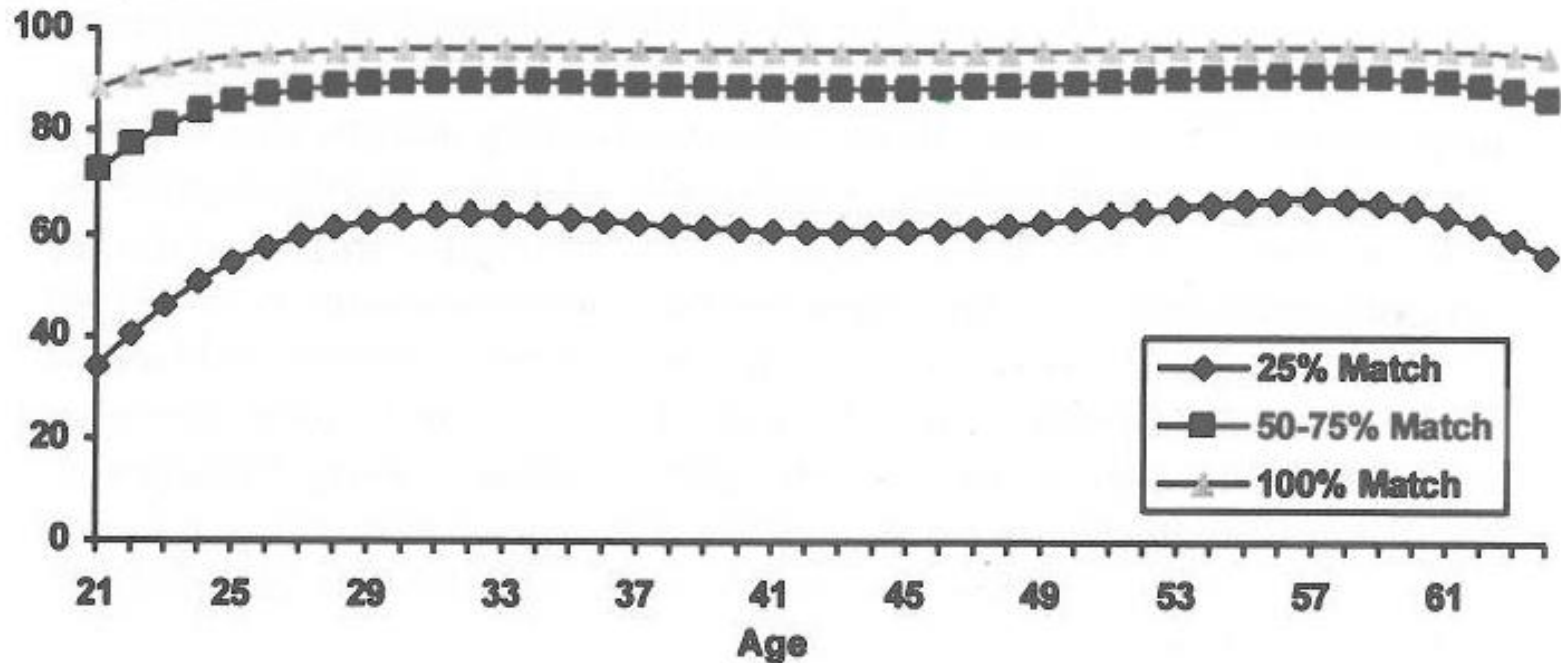
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# Matching contributions: the case of the US

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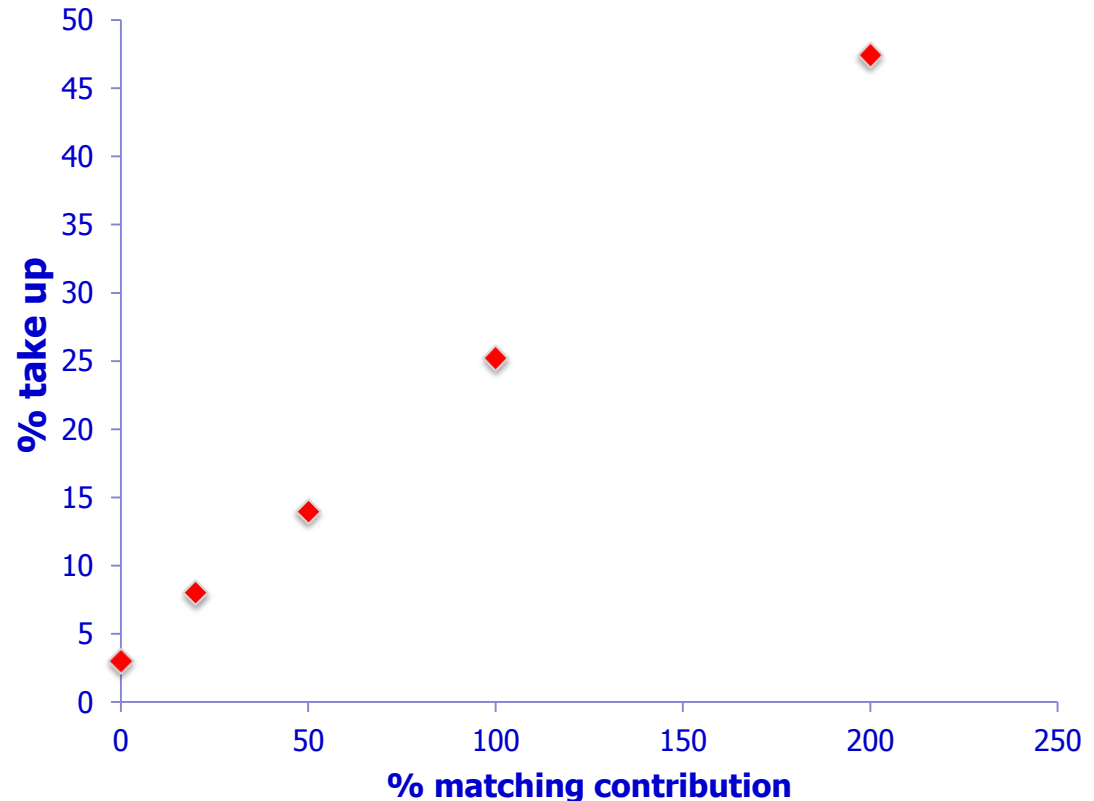
Participation rate



# Matching contributions: the case of the US

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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

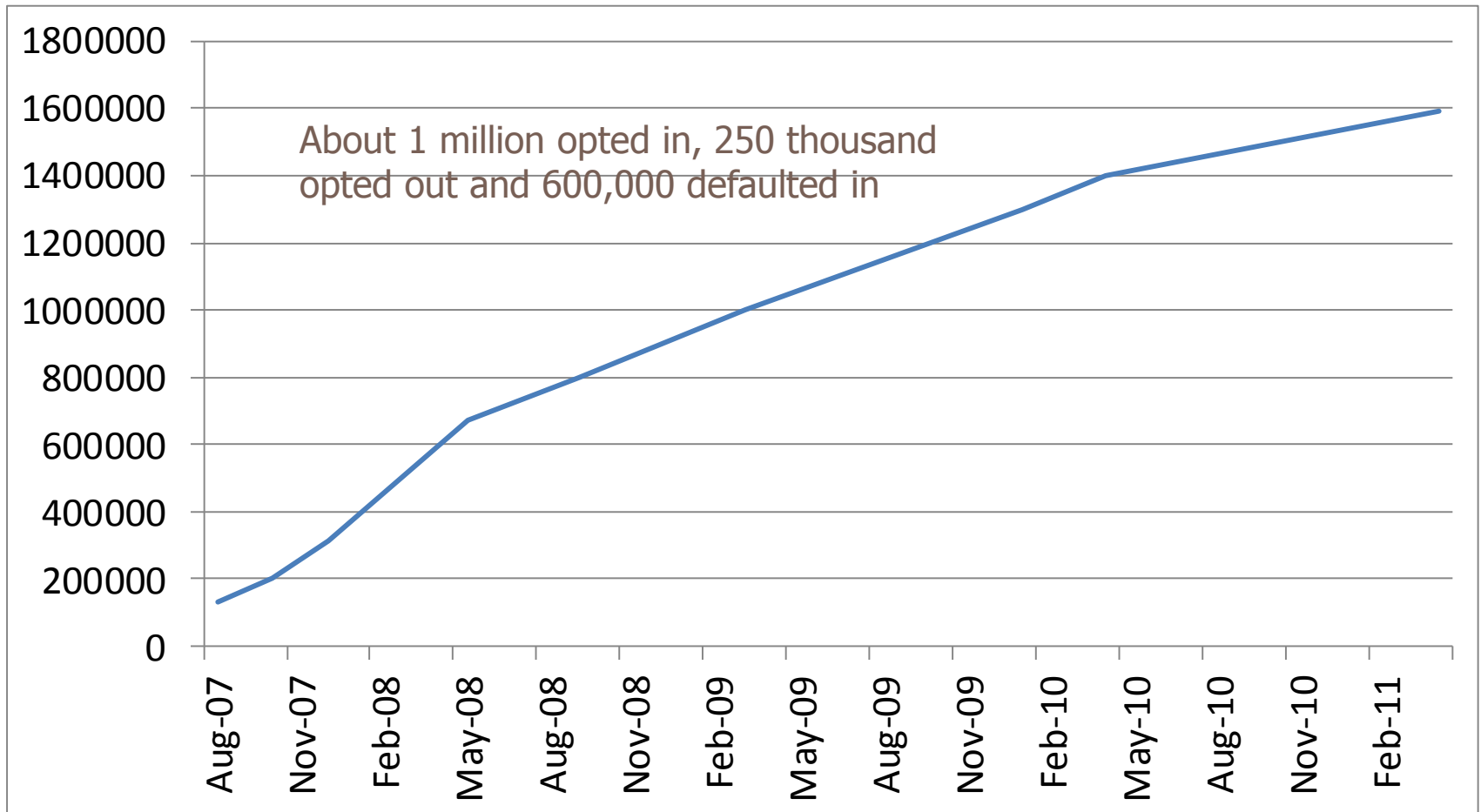
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- KiwiSaver has a range of membership incentives including:
- **\$1,000 kick-start**: The Government “kick-starts” accounts with a tax-free contribution of \$1,000.
- **Member tax credit**: The Government matches individual contributions by up to \$1,042.86 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

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# Some lessons

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- 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

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- 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

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- 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

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- 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

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- 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

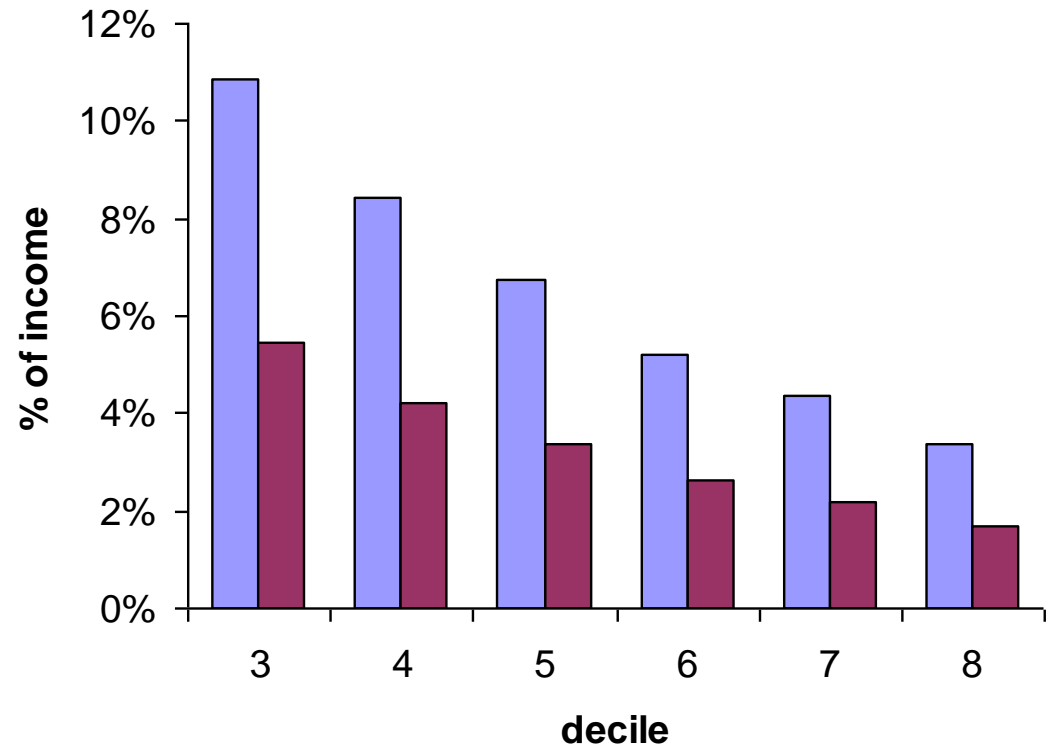
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- Affordability and incentives
  - ▣ Affordable contribution levels
  - ▣ Link with health/disability insurance where feasible
  - ▣ Voluntary pensions in rich countries exist due to tax treatment, but irrelevant for informal sector workers – a substantial 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?

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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

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- 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: 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

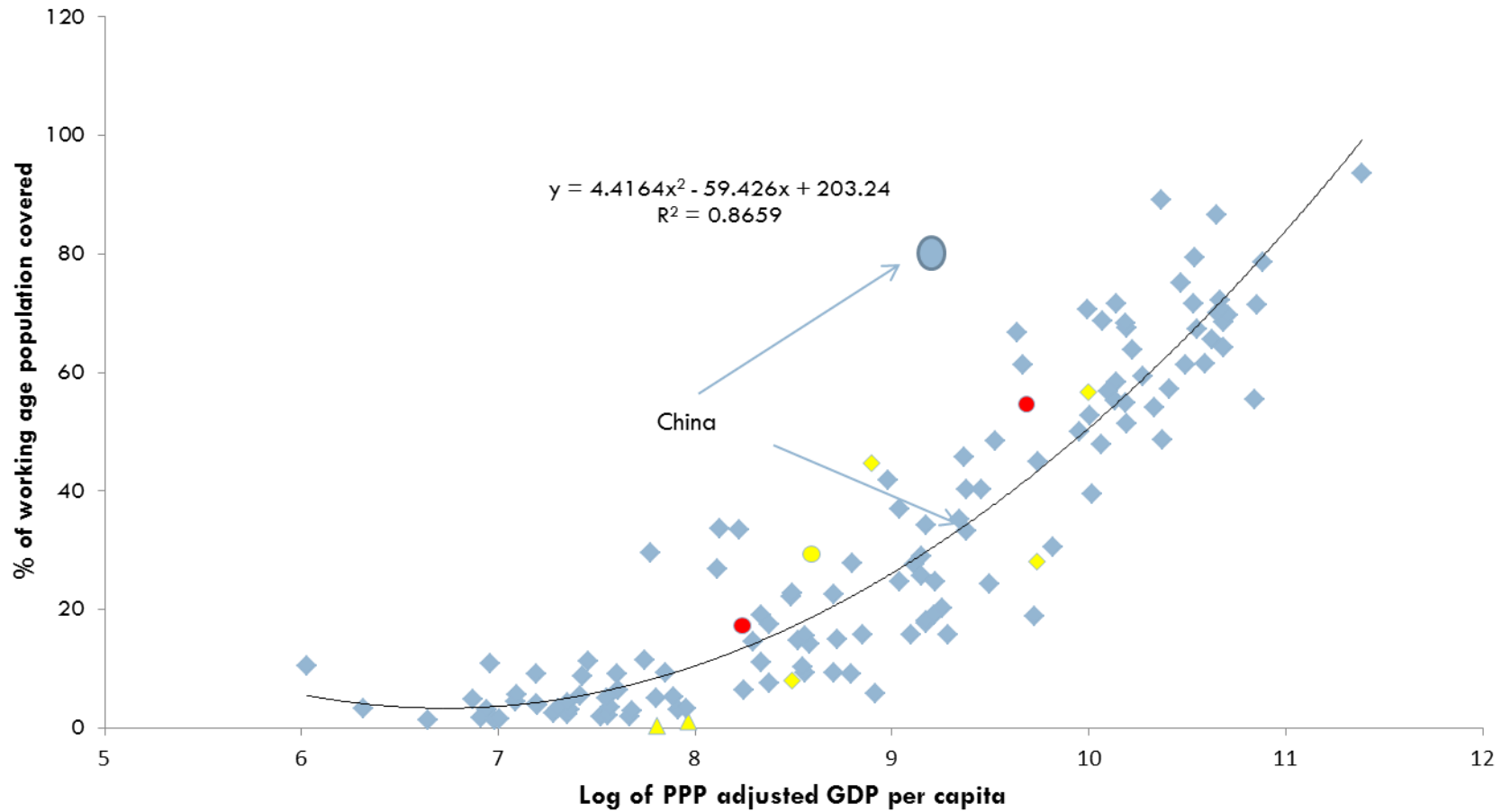
# Early evidence on demand side

- 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

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# Considering the parameters for matching

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- 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

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- 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

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- 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