The Role of the State in Managing the Cost of Ageing in Asia-Pacific

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The current trends in ageing in Asia-Pacific are too well known to bear repetition here. It is increasingly evident that Asia-Pacific will experience rapid ageing due to both - declines in fertility, and improved longevity. How Asia-Pacific addresses the ageing challenges will have a significant impact on how the global ageing challenge will be met.

My remarks focus on the selected aspects of the role of the state in managing costs of ageing in Asia-Pacific countries.

The Context

The context in which the State will need to play its role is characterized by extreme complexity. Not only are the demographic trends more adverse from the perspective of the cost of ageing, but there is considerable less certainty among the economists and among investment professionals about some of their long established analytical concepts, tools, and practices. Geo-economic and geo-strategic shifts underway accentuate the complexity.

The sovereign debt default is no longer inconceivable, and at the least, risk premium for rolling-over of existing debt and of new debt would rise significantly for those countries or sub-national governments that are perceived to manage their public finances poorly. Fiscal sustainability has therefore become a major issue, complicating the response of the state, particularly in redirecting fiscal policies towards enhancing good quality growth.

One of the important policy implications is the greater weight to be assigned to the precautionary principle in pension and health care policies. This principle suggests that any restructured pension and health care architecture should be such that a country is not locked into it, leading to high reversibility costs. We are familiar with the difficulties of reconfiguration of overly ambitious pension and other promises which can not be kept, but which have acquired legal or in the case of civil service pensions, constitutional, backing.

By 2050, China will have 430 million persons, India 330 million, and Indonesia 75 million persons above 60 years of age. Any hasty nation-wide pension or health care schemes which lock-in such large number of persons could be very costly economically and fiscally. The mixture of national and decentralized local pension and health care schemes, with requisite degree of reversibility, will however be a major challenge. At the minimum, a shift from welfare to effectiveness orientation will be needed.

Initiating Public Debate

The state will also need to shoulder the responsibility to initiate high quality debates on new social contracts for pensions (and health care) financing and related aspects, which focuses on demand, supply, social and political norms, and regulatory aspects. With longevity often increasing faster than the capacity of the political system to address it, and linkages between pension and health care expenditure, it is now essential to explore ways to jointly minimize the combined pension and health care expenditure for a desired level of provision.

In many low and middle income countries in Asia-Pacific, episodes of ill health will be an important reason why households may fall into poverty. Low health insurance coverage and high health care inflation are contributory factors for this phenomenon. This is another reason why pension and health care policies need to be coordinated.

Shifting thinking along these lines, with willingness to make organizational changes and fund solid empirical research to achieve coordination and minimize the joint costs of pensions and healthcare, should be an important component of this debate.

The legacy pension (and healthcare) issues need to be separated from the future social contract. This has been recognized in some Asia-Pacific countries such as Japan, South Korea, and to an extent in China, but greater efforts in this direction merit consideration.

Addressing Gender Imbalances

Persistent gender imbalance in the favor of males has been observed in many Asia-Pacific countries. To the extent such imbalances affect the dynamics of family formulation and relationships, and impact on the functioning of the labor markets; it has implications for pensions and healthcare.

Government policies can play a role in addressing this imbalance, though there is considerable uncertainty about the appropriate measures and their impact due to the interconnected nature of the current economic, social, political and perhaps security issues arising from the gender imbalance.

Retirement Income Security of Migrant Workers

In the Asia-Pacific region, there are considerable cross-border migrant worker flows. Addressing their retirement income needs will require regional cooperation among sending and receiving countries. As such cooperation is state-led, there is a role for regional organizations in evolving norms and codes of conduct, and in facilitating exchange of information.

Addressing Horizontal Equity

Another area where the state can play a role concerns what public finance economists call horizontal equity. In the literature, intra-generational equity issues have received relatively less attention. This area is particularly relevant where the coverage of formal pension schemes is low, confined to civil servants and employees of large public and private sector organizations as is the case in many highly populated Asian countries such as India, Indonesia, and China.

The issue is the following. If too small a proportion of labor force, such as civil servants, appropriate disproportionate share of current and future resources devoted to pensions (opportunity costs limit the share of GDP that can be devoted to pensions), it leaves large proportion of the elderly with too few resources, resulting in uneven benefits. Thus, parametric changes in civil service pension arrangements for existing beneficiaries are essential.

In the US, for example, there are attempts under way in the state and municipal pensions (where credibility of pension promise is under severe threat) to explore constitutional ways to change accrual rates and other parameters for pensions for existing beneficiaries.

The Hutton Commission Report in the UK has formed the basis for civil service pension reforms. These include a shift from final salary to career average revalued earnings, and linking normal pension age to state pension age (with special provisions for uniform services) (Williams, 2011).Through these measures the government aims to reduce the proportion of adult life spent in retirement of public service workers to about one-third, the same proportion existing in the 1980s. The proposals will also help to limit the impact of contribution increased across public sector retirement schemes, and thereby help manage the share of GDP devoted for civil service pensions. To be effective, this should not be done in isolation, but with complementary changes in labor markets and other areas.

Facilitating Bequest

The current arrangements in some countries, e.g. Japan, have made pensioners relatively better off than the younger cohorts, even as they have less promising “good” job prospects and higher social security burdens. Bequest is one of the instruments to manage inter-generational transfer. The fiscal arrangements surrounding bequests; reducing fiscal and regulatory arbitrage possibilities between pension products, pension providers, and pension regulators is another area where the state can make useful contribution.

The current and prospective challenging investment environment makes it even more difficult to earn higher than normal returns consistently on pension savings.

Converting PAYG schemes into even conventionally funded schemes is complex. Weak fiscal situations are not ideal to convert implicit pension debt into explicit one. Moreover, as noted the issue of whether the accumulated funds could be intermediated through financial and capital markets to raise core rate of growth needs to be addressed. In DC schemes, the pay-out phase has received relatively less attention. Annuity markets are unlikely to be organized on a large scale while addressing longevity and inflation risks in an affordable manner without the role of the state. More debate and research on product and process innovations and on risk sharing among the stakeholders during the pay-out phase of the DC schemes are needed.

Totalization Agreements

The state authorities should also consider giving greater priority to totalization agreements, which rationalize taxes and benefits relating to social security, just as Double Tax Agreements (DTAs) perform similar functions for the income tax. Such agreements could facilitate cross-border flows of people, and enhance equity for cross-border workers. Europe is attempting to construct regional agreement for this purpose, but wider range of agreements is needed to account of extensive cross-border flows.

Setting Poverty Floor: State can also play a role

In many low and middle income countries, the state can help strengthen public delivery systems for social pensions (and other social services); in constructing and maintaining relevant data bases; and in encouraging good quality policy relevant pension and health policy research. If social sector policies, such as pensions and healthcare are to be integrated into development strategies then more rigorous rationale and assessment of their long term development impacts are needed.

Among the high income Asian countries, Australia, Japan, and Korea have instituted social pensions. Means testing does not have to be direct. Thus, if social pensions are included as taxable income, the level will vary according to income tax bracket, even if the design proposes universal pension. Fiscal space and other poverty programs would be relevant in setting the social pension level.

Concluding Remarks:

The above discussion while not exhaustive, nevertheless, suggests that the effectiveness with which the state manages the cost of ageing in individual Asia-Pacific countries will have an impact on their broader international competitiveness and on domestic social cohesion.

The measures and their sequencing will depend on the context, capacities and specific economic, social, and political objectives and constraints of individual countries.

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