Social Security Policy

in an Era of Globalization and Competition

Challenges for Southeast Asia

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There are several themes which emerge from the comparative analysis of social security systems in Southeast Asia. Each country will need to address the limitations of their respective system in relation to each of the themes outlined. The first theme concerns the need for a multi-tier social security system. The second concerns the need for professionalism in designing and managing provident and pension funds organizations and schemes. The third theme concerns the need for a system-wide perspective. As these countries progress towards a multi-pillar system, it will be essential to ensure that all the different elements of the system are compatible with each other. There is therefore a strong case for considering establishing a regulator for the pension sector. Fourth, it is worth stressing that there is an urgent need to develop indigenous research capabilities in the area of social security. In none of the Southeast Asian countries do any of the universities offer specialization in this area. Finally, the development of appropriate social security systems should be regarded as an essential aspect of international competitiveness and of managing globalization, and not in conflict with them.

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I

Introduction

Globalization is a multi-faceted phenomenon covering economic, political, social, and cultural dimensions. It is not a new phenomenon, and does not have a standard definition. In economic terms, globalization may be broadly defined as the shrinkage of economic distances (i.e. ease with which each element of production-distribution-information-communication of the production and trade flows can be located over large geographical distances).

Three broad trends comprise the current phase of globalization. *First*, the advances in transportation, information and communication technologies, including the internet; *second*, strong tendency towards global, regional, bilateral, unilateral economic liberalization;[1] and *third*, rebalancing of state-market mix towards the latter, and greater recognition of the complementary role each plays. Most countries, including those in Southeast Asia have concluded that globalization is an irreversible process which they need to manage with the objective of emerging as net winners.

As China and India continue to pursue greater integration with the world economy, Southeast Asian countries are facing increased competition for markets, foreign capital and manpower, and simultaneously considerable opportunities in participating in their growth.

It is generally accepted that globalization has made safety nets even more essential for at least three reasons. First, for cushioning the burden of restructuring; second, for increasing legitimacy of reforms; and third, for enabling risk taking by individuals and firms by providing a floor level income in case of rewards from risk-taking not materializing.

Southeast Asian countries have embraced globalization. It is therefore not surprising that social security reform has become an important public policy issue in recent years. The 1997 East Asian crisis underscored the need for adequate social safety nets [The World Bank, 2000]. Demographic trends manifested in rapid individual and population ageing,[2] globalization and associated changes, urbanization, industrialization, and changing family structures and attitudes all suggest greater reliance on formal social security systems in Southeast Asia [Asher, 2002]. As these systems have a long lead-time

before they can provide adequate retirement income support in a sustainable manner, there is considerable urgency in initiating the reform process.

This is therefore an appropriate juncture to assess recent social security reforms in Southeast Asia, and suggest future directions. To make the discussion manageable, this paper takes a narrower view of social security which includes only the retirement financing[3]. It thus excludes other elements such as health care, unemployment, workmen compensation, food and fuel subsidies, disaster relief and others. The importance of the excluded areas however should not be minimized.

The rest of the paper is organized as follows. The next section (Section II) discusses the objectives of social security system and outlines a possible framework for social security reforms, particularly relevant for countries in Southeast Asia. Section III discusses wide divergences in the philosophy of social security systems in Southeast Asia, and the extent to which the core functions of the relevant organizations are being performed satisfactorily. Section IV outlines the main challenges facing the policymakers in reforming the social security systems in an era of globalization and competition involving complex trade-offs. In particular, coverage, adequacy, administrative efficiency and transparency, and governance and regulatory issues of provident and pension funds in selected Southeast Asian countries are briefly discussed. The final section provides the concluding remarks.

II

Objectives of System and the Five Pillar Framework

The core objectives of any social security system, for both individuals and government, are smoothing consumption over lifetime; insurance (particularly against longevity and inflation risks)[4]; income redistribution; and poverty relief. However, these have to be traded off against economic growth, labour market efficiency and flexibility, and against other needs like health, education, and infrastructure. Individual, fiscal and societal affordability should be kept in mind in reforming social security system. This implies that benefits promised must evolve overtime as affordability grows.

There are five core functions which any social security organization must perform [Ross 2000]. These are: reliable collection of contributions, taxes and other receipts, including any loan payments; payment of benefits for each of the schemes in a timely and correct way; securing financial management and productive investment of provident and pension fund assets; maintaining an effective communication network, including development of accurate data and record keeping mechanisms to support collection, payment and financial activities; and production of financial statements and reports that are tied to providing effective and reliable governance, fiduciary responsibility, transparency, and accountability. In most developing countries, organizational reforms aimed at performing the above five tasks in more professional and effective manner are a prerequisite for broader systemic reform.

At the systemic level, a well designed social security system should be broad based, i.e. be *adequate* both in terms of coverage and the range of risks covered; *affordable* from individual, business, fiscal, and macroeconomic perspectives; actuarially

sound and *sustainable* for over a period of 70 years of more; *robust* so as to withstand macroeconomic and other shocks; and provide reasonable levels of post-retirement income[5] (as determined by a considered evaluation of alternative and trade-offs within the society) coupled with a *safety-net* for the elderly poor.

The main role of pension system is to pay pensions. However, the impact of pension arrangements on economic efficiency, incentives to work and save, achieving fiscal consolidation and flexibility, international competitiveness, lowering labour market distortions, and on financial and capital markets should also be considered. As social security reform is a process that spans for over a decade or more, sequencing and scalability are also important. Effective reform needs to be directed toward better organizational effectiveness and the broader system design issues[6].

There has been considerable debate and experience with social security reform but no single idea, system or model has emerged even among Asian countries[7]. There has however been appreciation that from a practical policy point of view, a multi-tier framework is better able to address various social security risks than reliance on a single-tier. The World Bank's earlier report [The World Bank, 1994] suggested a three pillar/tier framework, but accumulated evidence and re-thinking has led the Bank to suggest a five pillar/tier framework (Table 1) [Holzmann and Hinz, 2005].

This system recognizes that different target groups require different combination of pillars; and that basic pension or at least social assistance financed from general budgetary revenues (Pillar Zero) is essential for the lifetime poor. This group may constitute as high as 30 percent of the total in some developing countries. It also recognizes that private management, investment allocation among wide variety of

physical and financial asset classes, and international diversification may not be suitable for all countries. There is also less insistence on private management of pension assets and recognition that accumulation of large assets is not always optimal. The role of family, community, physical assets (such as housing), and labour market activity after retirement (Pillar 4) also receive emphasis. The contextual aspects of each country must be given substantive consideration in provident and pension fund design and governance.

Table 1: Multi-Pillar Pension Taxonomy of the World Bank

	Target Groups				**Main criteria**	
Pillar	**Lifetime poor**	**Informal sector**	**Formal sector**	**Characteristics**	**Participation**	**Funding/collateral**
0	**X**	x	x	"Basic or "Social pension," at least social assistance, universal or means-tested	Universal or Residual	Budget/general revenues
1			X	Public pension plan, publicly managed, defined-benefit or notional defined-contribution	Mandated	Contributions, perhaps with financial reserves
2			X	Occupational or personal pension plans, funded defined-benefit or funded, defined-contribution	Mandated	Financial assets
3	x	X	X	Occupational or personal pension plans, funded defined-benefit or funded, defined contribution	Voluntary	Financial assets
4	x	X	X	Personal savings, homeownership, and other individual financial and non-financial assets	Voluntary	Financial assets

Note: The size of x or X characterizes the importance of each pillar for each target group.
Source: Holzmann and Hinz (2005).

III

Nature and Philosophy of Social Security Systems

The Southeast Asian countries exhibit considerable divergence in their social security systems and philosophies (Table 2). Each country has a separate pension and provident fund organization for the private and government sector respectively. The systems for these two sectors are not integrated.

Table 2: Key Provident and Pension Fund Indicators in Southeast Asia

Country	Organizations	Contributors as Percent of Labour Force[a]	Contribution Rate (2004)	Wage Ceiling (2004)	Member Balances (USD Billion), Percent of GDP
Malaysia	Employees Provident Fund (EPF)	48.7[b]	23.0	No	68.0, 51.2 (early 2005)
	Government Pension Fund, Malaysia (GPF)	NA	NA	No	NA
Philippines	Social Security System (SSS)	20-25[c] (2003)	8.4 (5.07/3.33)	P 15,000 per month	3.3, 3.8 (2004)
	Government Service Insurance System (GSIS)	4.5 (2003)	21.0 (12/9)	No wage ceiling	3.7, 4.3 (early 2005)
Singapore	Central Provident Fund (CPF)	60.0[d] (March 2004)	30.0[f]	$4,500 month (2006)	66.4, 61.9 (2004)
	Government Pension Fund, Singapore (GPF)	NA	NA	NA	NA
Thailand	Social Security Organization (SSO)	21.2[e] (2003)	6.0	B15,000 month	20.0, 11 (early 2005)
	Government Pension Fund, Thailand (GPF)	3.5(2003)	6.0	Yes	NA

Notes:
NA: Not Available.
[a] Figures in brackets refer to year to which data refers.
[b] Includes 4017 foreign workers.
[c] Membership in the SSS is 23 million but the active contributors are 6-8 million.
[d] Foreign workers are around 25 per cent of the labour force and are excluded.
[e] The SSO coverage is overstated as the figure refers to members rather than active contributors. If the provident funds of SOE's are included, the coverage rate may be as high as 25%.
[f] This rate applies to those below 55 years of age. Lower rates apply to those above 55 years.

Sources: Information obtained for official sources in each country.

The nature of the formal social security systems in Southeast Asia reflects both continuity and adaptation. Among the Southeast Asian countries, Singapore and Malaysia essentially rely on a single mandatory savings pillar (Pillar 2 in Table 1) for retirement financing. In these two countries civil service pensions are of defined-benefit type[8] based on a formula incorporating years of service, salary level, and other factors. There is however no automatic indexation. In Singapore, only top civil servants are covered by the pension scheme, while in Malaysia all civil servants are covered. Malaysia is considering requiring civil servants to contribute for their pensions, but it is unlikely to alter the defined benefit nature of the scheme. Malaysia's method of financing its civil service pensions (through the budget) is likely to come under strain unless some substantive pre-funding provisions are made.

Malaysia and Singapore however do not accept defined benefit and social risk pooling method for private sector employees. The mandatory savings pillar provides individual but not social security; and leaves individuals open to longevity and inflation risks. It also does not de-link retirement provision from macroeconomic and other shocks [Diamond, 2004].

Philippines and Thailand have accepted the principle of social insurance and defined benefit method for both the private sector and the government employees. In

2004, Indonesia passed a law on National Social security System (SJSN Act No. 40/2004). It aims to apply the social insurance principle on a comprehensive basis. It covers health insurance, work injury, old-age (provident fund), pensions, and death benefits. The law further stipulates that the government will develop social assistance programmes. This corresponds to the zero pillar in the five-pillar framework discussed in Section II. There are however concerns that there is a serious mis-match between the objectives of the law on one hand and financial, institutional, organizational and regulatory capacities to implement the law on the other. The impact of this law on employment growth also needs to be considered. Therefore careful sequencing and planning are needed before implementing the law.

In the Philippines Social Security System (SSS) and the Government Service Insurance System (GSIS) provide comprehensive set of benefits to covered workers. Philippines is planning to introduce a mandatory savings pillar, but no firm decision has been taken so far.

Thailand decided to introduce social insurance based pensions for private sector workers in the midst of the 1997 crisis. The first pensions to private sector employees however will not be paid until year 2013. Thailand thus has scaled its system keeping affordability in mind. In addition to unfunded defined benefit pensions, civil servants in Thailand also compulsorily belong to a provident fund called Government Pension Fund (GPF). Under the 1987 Act, Thailand requires all firms listed on the stock exchange to operate provident funds but does not require employees to join.

Thailand's Social Security Organization (SSO) provides comprehensive coverage of various short-term and long-term risks including old age pension, disability, sickness

and maternity, work injury, health benefits, survivors' benefits and unemployment. Since 2004, Thailand has also introduced unemployment insurance. Thailand is unusual in providing such an array of benefits under a single organization, i.e. SSO.

Among the countries in Southeast Asia, Thailand therefore has made relatively more progress towards a multi-pillar system than the other sample countries. Philippines have been planning to introduce a mandatory savings pillar, but no firm decisions have so far been made. In none of the four countries does the zero-pillar involving social pension financed from budgetary revenues play a significant role. For the lifetime poor, this is among the most important pillar. In affluent Singapore, the social assistance is deliberately kept at below even the bare subsistence level. To receive even this meagre amount, extremely stringent criteria are applied [Asher, 2004]. Singapore has thus scarcely progressed beyond the philosophy of poor laws in England, which held poor themselves solely responsible for their poverty.

The above discussion suggests significant divergence in social security philosophy among the four countries. There are also wide differences in the effectiveness with which the core functions are being performed by various provident and pension fund organizations in Southeast Asia. The two countries with higher per capita income, i.e. Singapore and Malaysia have persisted with a single-tier system, while Thailand is making efforts to develop a multi-tier system in a gradual and sustainable basis. Examining the reasons for such fundamental differences in the philosophy of social security systems among Southeast Asian countries is beyond the scope of this paper. Some analysts have however argued that political systems and regime autonomy are an important element of the explanation [Ramesh with Asher, 2000].

It should be noted that in countries such as Philippines and Thailand, which have accepted the social insurance principle, the accumulation of balances in the mandated programmes is likely to be relatively low. In the two countries, accumulated balances to GDP ratio is around 10 percent (Table 2). In contrast, countries which rely on mandatory savings as the primary pillar, the accumulated balances to GDP ratio is likely to be high. In Malaysia, this ratio is over 50 per cent, while in Singapore it is over 60 per cent. (Table 2).

IV

Challenges

The social security arrangements in Southeast Asia face many challenges. These may be grouped under coverage, adequacy, administrative efficiency and transparency, and governance and regulation. Each is discussed in turn.

Coverage

Table 2 provides coverage (ratio of contributors to total labour force) in four Southeast Asian countries. The coverage has been relatively low (about a quarter of the labour force) in countries such as the Philippines and Thailand, where the formal sector is relatively small. In Malaysia, the Employees Provident Fund (EPF) covers one in two workers. In Singapore, three fourths of the labour force is covered. But as about a quarter of the labour force is foreign, and these workers are statutorily not included in the Central Provident Fund (CPF), the coverage may be regarded as high.

The above suggests that in any employer-employee relationship based systems, level of formal sector employment acts as a constraint on coverage. Two implications

emerge. *First,* the formal sector employment needs to be increased through domestic reforms (for example labour market reforms), and through increasing the employment elasticity with respect to GDP. Clear rules about who is covered essential. Good management systems should be developed to ensure that wages reported are consistent with actual wages paid to members. The formal sector coverage can also be expanded through improved administration and compliance. For this purpose, unique identification number for the members and strong IT support are essential.

Second, the needs of the informal sector workers should be addressed[9]. This however poses difficult challenges, particularly as such workers are found in both urban and rural areas, and the sector is very heterogeneous in terms of income levels, occupations, assets ownership etc. Therefore, it is more difficult to cover and has high administrative costs. So, evidence-based public policies to target particular type of persons for coverage; and designing specific schemes to reach them are essential.

In most of the countries there are identifiable occupations which employ large number of people. These may include fisherman from a particular area, small tobacco growers, and handicraft workers concentrated in a small area. Specialized coverage scheme including possible livelihood insurance could be devised for such identifiable large groups to sustain their incomes and to organize them in cooperative bodies.

In Southeast Asia, coverage of workers employed in foreign countries is also an important issue. Philippines, Malaysia, Thailand and Myanmar are major labour-exporting countries. Malaysia and Thailand, along with Singapore are major importers of foreign labour from the region.

Addressing the social security needs of these workers therefore requires a regional agreement. ASEAN Social Security Association (ASSA), formed in 1998, might be an appropriate forum to discuss the possibility of a regional agreement on minimum coverage standards and reciprocal arrangements.

Adequacy

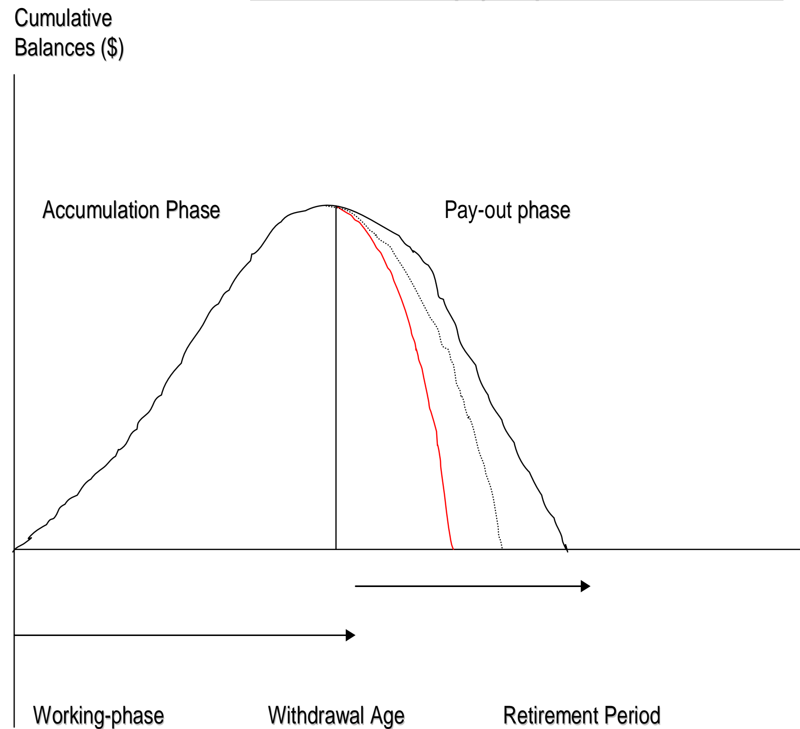
A pension system needs to address not only poverty alleviation objective, but also permit maintenance of accustomed standard of living. Pension experts usually recommend a replacement rate, i.e. ratio of retirement income over pre-retirement income of between two-thirds to three-fourths of the income, which is maintained throughout retirement period through addressing of longevity and inflation risks[10]. It should be stressed that the requisite replacement rates should be derived from different pillars and not from one pillar alone.

The dual nature of the social security systems in the four countries have meant that in general civil servants (including armed forces personnel) have obtained reasonably high replacement rates, with longevity and inflation risks protection. The methods however vary. Thus in Malaysia, when government salaries are revised, a similar revision is also undertaken for the pensions of the retired civil servants.

The above suggests that the main challenge of adequacy concerns the private sector employees. As noted, social assistance or basic pensions financed through the budget are essential for the lifetime poor (Table 1). In none of the four countries, the

zero-pillar plays a significant role. With the exception of the Philippines, fiscal position of other countries is comfortable. Thus, the fiscal constraint is *not* a factor in application countries.

Figure 1
Accumulation and payout phases of DC schemes



Cumulative Balances = Net contributions (contributions minus withdrawals), plus interest credited on accumulated balances.
Payout phase: the funds accumulated can be spent rapidly or slowly. Death may occur before the funds are exhausted or reverse is also a possibility. So need to protect against longevity risk. As it is the purchasing power of the funds that is relevant, protection against the inflation risk is also desirable.
Source: Author

The main constraint is the current socio-political norms which do not regard provision of a floor level of income as an essential element of a good society.

In Malaysia and Singapore, the private sector workers are covered under the mandatory savings schemes. There are two phases in such schemes, the accumulation phase and the payout phase. In the accumulation phase the balances at retirement depend on the contribution rate, the wage base, the extent of pre-retirement withdrawals, and the real interest rate credited to member's accounts. At the time of retirement, arrangements must be made for a phased payout. This is because a lump sum payment is not consistent with the primary rationale of mandating savings on the basis that people are myopic. As people become older, they do not necessarily become wiser. The concepts used in the behavioural finance literature such as lack of self-control, inadequate pension finance

literacy, herd mentality and others remain as valid for the elderly as they are for the young [Holzmann and Hinz, 2005; Asher, 2004].

In Malaysia and Singapore, substantial pre-retirement withdrawals have tended to severely impact on the accumulation of balances, even though contribution rates and wage growth have been high [Asher, 2002]. Such withdrawals as percent of contributions averaged around 40 percent in Malaysia, and around 70 percent in Singapore for a prolonged period [Asher, 2002].

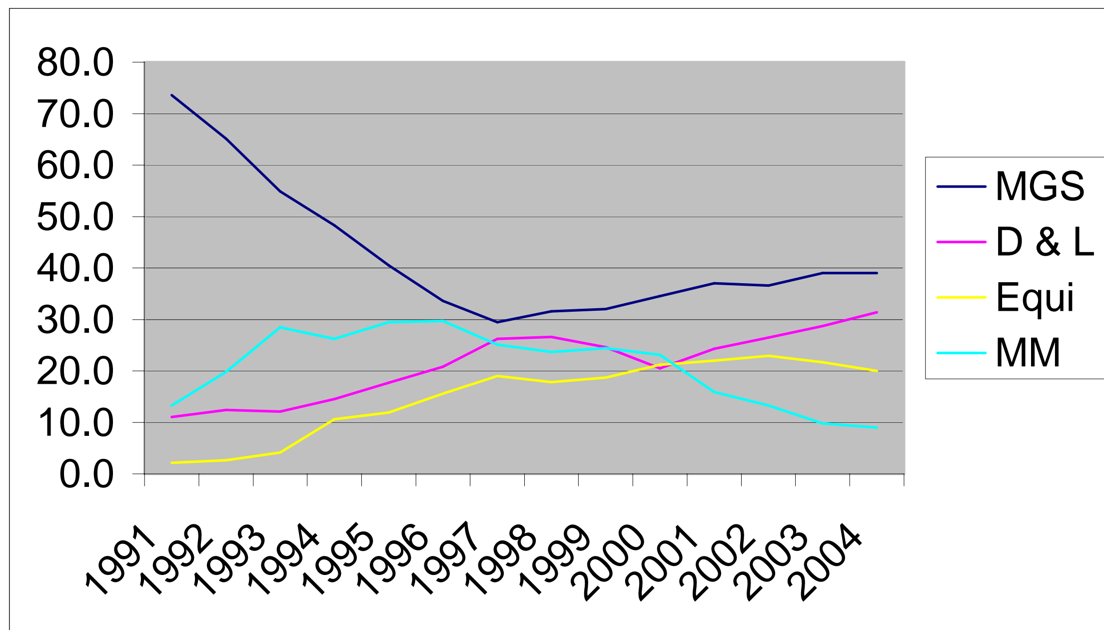
Singapore's CPF members have not benefited from the power of compound interest. We have estimated that the real rate of return credited to CPF members was only 1.2 percent per annum during the 1987-2004 period. In contrast, the corresponding rate credited to Malaysia's EPF members was nearly three times that in Singapore[11].

Malaysia's EPF thus has harnessed the power of compound interest much better over a longer run than Singapore. The real rates of return in Latin American countries have been substantially higher, but more volatile [Gill *et al*., 2005]. The decentralized nature of the pensions system in Latin America has meant that the net real rates of return (gross rates – administration and investment management costs) are likely to be lower (about 5 percent per annum) than the gross rates (about 10 percent) [Gill *et al.,* 2005].

The EPF balances are wholly domestically invested in Malaysia. Some consideration is however being given to investing abroad as at current accumulation rates, the EPF balances will soon outstrip the stock market capitalization. The EPF investments are well-diversified among domestic asset classes (Figure 2). It is particularly noteworthy that since 1991, the share of Malaysian Government Securities (MGS) has declined significantly while the share of equity investments has correspondingly increased. The

size of the domestic capital markets[12] is acting as an increasing constraint on EPF's investments. The Malaysian government has permitted EPF to invest up to RM 1 billion (out of total balances of nearly RM 250 billion) abroad. The EPF is in the process of operationalizing such investments.

Figure 2
Malaysia: Investment Allocation of EPF: 1990-2004



Note: MGS – Malaysian Government Securities; D & L – Debentures and Loans; Equi – Equities; MM – Money Market.

Source: Calculated from the Annual Reports of the EPF.

In Philippines and Thailand also the provident and pension fund assets are currently wholly domestically invested. As of September 2003, the SSS in the Philippines had total assets of P 171.3 billion (4 percent of the GDP), and total investments of P 155.4 billion (3.6 percent of GDP). The allocation was 29.1 percent in equities; 26.3 percent housing loans; 19.6 percent salary loans; and 5.0 percent real estate.

As at June 30, 2003, GSIS had total assets of P 245.9 billion (5.7 percent of the GDP), substantially higher than for the SSS. The SSS membership as of September 30, 2003 was 24.9 million (assets of P 6880 per member). In contrast, the GSIS membership was 1.4 million (assets of P 175,643 per member). For the January-September 2003 period, the average monthly pension paid by the SSS was P 2526 (USD 45), about half of per capita income.

In Thailand, in 2003, the GPF's portfolio of Baht 230 billion (US$ 5.5 billion) was 80 percent in fixed income instruments; 15 percent in equities; 3 percent in real estate, and 2 percent others [Kanjanaphoomin, 2005]. There has been considerable pressure on the GPF under the current government to support the Thai stock market and invest in projects deemed of national importance by the government. Thailand is considering investing a small proportion of GPF balances abroad.

In the case of Singapore, the CPF's balance sheet shows that all the balances are invested in non-marketable government securities. The interest on these securities are determined retrospectively as a weighted average of one year fixed deposit rates and savings account rates of the four domestic banks. The interest rate credited to members is therefore an administered rate. As Singapore government has exhibited budgetary surpluses for many years, the bond proceeds are in effect handed over to Singapore Government Investment Corporation (SGIC) and other holding companies. Statutory provisions protect these SGIC and others from disclosing their investment portfolio and performance. Thus, CPF members do not know the ultimate deployment of their savings. Besides the potential implicit tax (difference between returns obtained by SGIC and

others and returns actually credited to members), the above arrangement also carries high political risk and is not conducive to transparency and accountability.

A simulation study by McCarthy *et al*. (2001) suggest that for a representative CPF member who begins contributing in the year 2000 under then prevailing rules, about three-fourths of the total CPF wealth will be in the form of housing in the base case and the replacement rate will be 28 percent. The rate will decline to 17 percent if the contribution ceiling of S$6000 per month is held constant in nominal terms. The rate will be lowered to 14 percent if the contribution rate is reduced from 40 percent to 30 percent. Even if the real rate of return of 5 percent is credited to members, the replacement rate increases to only 34 percent.

The above rates are clearly inadequate. Subsequent to the simulation study the nominal wage ceiling has been lowered substantially (it is currently S$4,500), and so has the contribution rate. This suggests that if the proportion of housing wealth in total CPF wealth remains at the base case level, the replacement rates will be in the early teens. This shows the danger of relying on mandatory savings scheme alone to finance retirement.

The EPF authorities in Malaysia have not published the replacement rate for its members. While the replacement rate is expected to be somewhat higher than Singapore in spite of the lower contribution rates, it is unlikely to exceed 25-30 percent for the middle income workers. This is also clearly inadequate and calls for a multi-tier system.

The replacement rate of SSS in the Philippines and SSO in Thailand are not available. Pensions under Thailand's SSO when they commence in 2013 are likely to be quite modest. This is because of low contribution rates and conservative investment

management practices [Kanjanaphoomin, 2005]. The current plans are to provide 15 percent of average wage of the last 60 months of the member for those who have contributed for 15 years. For those contributing for a longer period, the benefit will increase by 1 percentage point for every 12 months of contribution. Thus, a person contributing to Thailand's SSO for 30 years will be entitled to a replacement rate of 30%, assuming the base is the average wage for the last 60 months. There are no plans for inflation indexation but longevity protection is provided.

The Payout Phase: In Malaysia, one-third of the balances can be withdrawn at age 50 and the rest at age 55. Given the life expectancy at birth of 70 for men and 75 for women (life expectancy at age 55 is likely to be higher); the withdrawal age is too low. Moreover, the withdrawals are in a lump sum.

The EPF did attempt to organize a deferred annuity scheme under which a member can purchase a desired amount of monthly annuity income anytime during his working years. A member could make annuity purchases in small amounts throughout the working career. As Malaysia does not have long term assets such as bonds in which insurance companies providing such annuities could invest, they naturally took a very conservative view of the risks involved. As a result, the rate of return offered on the deferred annuities was significantly lower than the dividend paid by the EPF. Hence, this scheme was not successful. The government is however considering issuing special bonds for pensioners. Whether these help provide at least partial inflation protection will depend on the terms and conditions of such bonds.

In Singapore, the withdrawal age for the CPF is 55 years. However, a minimum sum (S$90,000 since July 1, 2005, 50 percent of which may be pledged in the form of

property) must be put aside and income from it can not be used until age 62. This effectively increases the withdrawal age for a portion of the accumulated balances. However, proportion of members buying annuity is quite small. Most deposit it with the approved bank or keep it with the CPF Board. The longevity and inflation risks are therefore not addressed.

The tax treatment of the annuities and other pension products should also be made more neutral, both with respect to various instruments designed to provide an income flow during retirement, and with respect to providers [Asher, 2004][13].

The challenge in the Philippines is to make the SSS benefits financially sustainable. The essence of the challenge is that the political system in the Philippines has the tendency to expand the benefits provided by the SSS but without increases in contribution rates or permitting better investment management and diversification [Asher, 2002; Templo, 2002]. While the GSIS is well funded and therefore the civil servants are likely to obtain adequate replacement rate[14], if the current policies continue, the SSS is unlikely to financially sustain the promised benefits. This suggests an urgent need to base the operations of the SSS on sound actuarial principles. If this is not done then either the shortfall will have to be made-up from the budget, or sharp reductions in benefits, or increases in contributions will become necessary in the future. The former aspect will adversely impact on fiscal consolidation and flexibility; while the later option will have political costs.

The provident funds in Thailand permit a lump sum withdrawal. Therefore its members are not protected against longevity and inflation risks.

Administrative Efficiency and Transparency

There are several reasons why high level of administrative and compliance efficiency is essential. *First*, any real cost savings in administration translate into higher rates of return to members. Similar savings in compliance costs to employers and employees result in positive impact on labour markets as these reduce the real burden of statutory levies. *Second*, compliance costs may affect the default rate by the employers, and willingness of employees to cooperate in circumventing statutory provident and pension fund contributions. These indirectly impact on the effective coverage of social security schemes. *Third*, high degree of administrative and compliance efficiency is essential for sustaining the legitimacy of the social security arrangements.

The designs of the provident and pension fund schemes have important bearing on the administrative costs. In general, decentralized employer or individual based systems exhibit higher administrative costs, though these may be offset by potentially higher rates of return on investments [Gill *et al*., 2005]. The investment management costs need to be separated from the administrative costs which involve operations of provident and pension fund organizations. Both these aspects however have been under-researched in the four countries. As a result only some broad comments are made.

In general, administrative efficiency as measured by conventional indicators is fairly high in Malaysia and Singapore (Table 3) .[15]

As may be noted from the data in Table 3, operating costs as a percentage of contributions in Malaysia are larger (1.68 percent as compared to 0.88 percent for Singapore) due to lower contribution rates (23 percent as compared to 33 per cent in Singapore) and its larger physical size requiring substantial coordination across large

distances. The cost as percent of Funds under Management (FUM) were substantially smaller (0.11 for Singapore and 0.15 for Malaysia), due to the large asset base of their provident funds (Table 2). The efficiency indicators for employee of the EPF are somewhat better than those of Singapore's CPF.

Similar analysis for Philippines and Thailand is not available for 2004. In the Philippines, the administrative costs as percent of contributions and as percent of assets of the SSS were 13.9 percent and 2.3 percent respectively in 2000 [Asher, 2002][16]. These are substantially higher than the corresponding values for Malaysia and Singapore. The 1999 data for Thailand's SSO suggests that the respective ratios were 3.9 percent and 1 percent [Asher, 2002]. While these ratios are substantially better than those of the Philippines they are still much higher than in Malaysia and Singapore. Philippines and Thailand therefore need to consider ways to bring about real costs savings in administration of social security schemes.

There are no studies on the compliance costs by the employers and by the employees of the provident and pension funds in the four countries. This area deserves much greater research emphasis.

Governance and Regulation

The importance of good governance in both private and public sector organization has been increasingly recognized. In the case of provident and pension funds, the relevant areas are: the composition of the Board and its access to expertise; fiduciary responsibility, transparency and accountability; disclosure norms; and actuarial analysis [Asher and Nandy, 2006]. Individual account based savings schemes, whether mandatory

or voluntary require sophisticated regulatory regime and financial and capital markets [Munnell and Sunden, 2004; Holzmann and Hinz, 2005; Gill *et al*., 2005].

Provident and pension funds require Board members who are independent-minded and competent. They should be highly conscious of their fiduciary responsibilities. The relevant laws and regulations should give high priority to such responsibilities.

In all four countries, there is a tripartite representation on the Board (government, employees, and employers), and provision for experts. The provident and pension fund organizations however are closely tied to the respective ministries. In Malaysia, the EPF is under the Ministry of Finance; Singapore's CPF is under the Ministry of Manpower; the SSS and the GSIS in Philippines are under the Office of the President; and Thailand's SSO is under the Ministry of Labour and Welfare, while the GPF is under the Ministry of Finance.

The Board appointments in the four countries are made by the Minister (or the President). Given the political economy prevailing in these countries it has been a major challenge to find Board members who are both competent and independent-minded. In these countries, the requirement that the Board members must give high priority towards fiduciary responsibilities towards members is fairly weak.

The mono-centric power structure and treatment of even routine socio-economic data as a strategic resource rather than public good are dominant characteristics of Singapore's political economy. The governance structure of the CPF, including its Board composition (and investment policies), reflect these characteristics. In the Philippines, the leadership and policies of the SSS and the GSIS has been closely tied to the prevailing

political power structure [Templo, 2002]. Thailand's SSS and GPF operate within the governmental structure. GPF aspires to be a professional organization with good governance practices. But its autonomy is constrained by governmental goals and objectives.

In Malaysia, the investment panel of the Employees' Provident Fund (EPF) is separate from the Board and reports directly to the Minister of Finance. While this permits introduction of outside expertise in investment decisions, it also dilutes Board's authority and autonomy [Thillainathan, 2005].

In none of the four countries is there an independent regulator for provident and pension funds. This particularly impedes requisite emphasis on the fiduciary responsibilities and professional developments of these organizations. Actuarial studies by the SSS of the Philippines estimate that at current levels of contribution rates, benefits and investment income, the SSS will become insolvent by 2015 [17]. But there is no requirement that authorities, whether the Congress, the President's office, the SSS Board or any other agency act on this publicly available information. In any social insurance scheme, matching of assets and liabilities is an essential part of good governance.

Thai law does not indicate what fiduciary duties of the Provident Fund Committee are. It also does not have a Trust Law. The lack of regulator also hampers system-wide perspective of the social security systems in these countries.

There is considerable room for improvement in the timeliness and accessibility of data concerning the operations of the provident and pension funds in these countries. The transparency and accountability levels therefore need to be improved. Again, a regulator would be better able to enforce guidelines concerning these aspects.

The transparency and accountability of the civil service schemes are especially low in all the four countries [Asher, 2000]. It is strongly suggested that the civil service schemes in these countries be subjected to frequent actuarial evaluation and that these be made publicly available to all the stakeholders. At a future date, these schemes should also come under the purview of the pension's regulator.

It should be stressed that in developing countries, pension's regulator also needs to play a developmental role. This involves enhancing pension economics literacy among the policymakers as well as the general public; and facilitating orderly development of different components of the pensions industry. Co-ordination between pension's regulator, insurance industry regulator, and the stock market regulator is essential.

V

Concluding Remarks

There are several themes which emerge from the comparative analysis of social security systems in Southeast Asia. Not all themes are applicable to the same degree in each country as the local contexts, and political, demographic, and other conditions differ. However, each country will need to address the limitations of their respective system in relation to each of the themes outlined below.

The *first* theme concerns the need for a multi-tier social security system. The need for multi-pillar system is particularly relevant for Malaysia and Singapore, and to a lesser extent for the Philippines. Thailand and the Philippines need to strengthen the zero-pillar of social assistance or flat universal pensions financed from the budget. Indonesia needs to carefully consider how to translate ambitious goals incorporated in the 2004 law into effective outcomes.

The *second* theme concerns the need for professionalism in designing and managing provident and pension funds organizations and schemes. As in other areas of public policy, such as tax reforms, it is the professional level attention to details of design and implementation which are crucial. It is important to keep in mind that the primary objective of any provident or pension fund is to provide retirement income security for members. Too complex an objective function for these organizations is therefore likely to be counterproductive. This is particularly the case in Singapore and to a lesser extent in Malaysia. The governance structure, and in particular the fiduciary responsibilities, become important elements of professional approach to provident and pension fund design and management. The importance of maintaining high level of administration and compliance efficiency in managing provident and pension funds should not be minimized.

The provident and pension funds need to perform the investment function utilizing the modern portfolio management principles and practices. The investment function will become increasingly complex, and appropriate strategies, including international diversification may need to be considered. For Singapore, the main task should be to ensure that the investment returns ultimately obtained by government holding companies are actually credited to the members.

Another aspect of professionalism concerns transparency, accountability, and timeliness of information provision to the stakeholders. In all four countries, substantial improvements in these areas are needed, particularly with respect to the civil service and armed forces schemes. A professionally managed organization is also adept at using outside expertise, whether on its Board or as outside consultants or service providers. The emphasis however should not be on the form but the substance of the arrangements. It

may be useful for the provident and pension fund organizations in these countries to consider appointing outside advisory committees. Their role will be to convey current stock of knowledge and relevant market realities to the Board, thus improving policy making and practices. The committees may be particularly helpful in facilitating the investment function.

The *third* theme concerns the need for a system-wide perspective. As these countries progress towards a multi-pillar system, it will be essential to ensure that all the different elements of the system are compatible with each other. As the financial entities involved in the accumulation phase and the payout phase may be different, there is a need for coordinating between different agencies supervising or regulating them. Currently, different rules and standards apply to private sector schemes on the one hand and the civil service scheme on the other. Often the same provident or pension fund organization acts as a service provider as well as supervisor or regulator of the exempted provident and pension fund plans. The responsibility for different elements of social security system is diffused with little coordination.

There is therefore a strong case for considering establishing a regulator for the pension sector. The regulator should not only require professionalism from all provident and pension fund organizations, whether public or private, but also ensure that the progress towards a multi-pillar system proceeds in a rational and sustainable manner. This will not be an easy task and the political economy considerations will undoubtedly play an important role. However, without a strong and independent regulator, it is also difficult to envisage how the challenges of social security will be met in the four countries.

Fourth, it is worth stressing that there is an urgent need to develop indigenous research capabilities in the area of social security. In none of the Southeast Asian countries do any of the universities offer specialization in this area. To make progress in this area however, the authorities will need to regard socio-economic information in general, and information concerning operations of provident and pension funds in particular, as a public good rather than as a strategic resource to be used for tactical purposes. Much of social security research is contextual and institutional, specific to a particular society. It is only through genuine cooperation and desire to improve social protection for those in the informal sector and for the elderly poor that innovative but locally relevant policies and programmes can be designed and implemented.

Finally, development of appropriate social security systems should be regarded as an essential aspect of international competitiveness and of managing globalization, and not in conflict with them.

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[1] This has been earlier confined to capital and finance, but strong logic requires that movement of natural persons (human resources) should also be liberalized, albeit in socially and politically sustainable manner. It is recognized that economic liberalization which is not undertaken at the global level through World Trade Organization (WTO) could hinder emergence of truly multilateral trade and investment regime.

[2] The total fertility rate, defined in terms of children per woman, in 2000-2005 period (medium variant) was higher than the replacement rate of 2.15 in countries like Indonesia (2.37), Malaysia (2.93), and Philippines (3.22); and below in Singapore (1.35) and Thailand (1.93)(United Nations, 2005).

Individual ageing refers to increased life expectancy. In 2000-2005 period, life expectancy at birth for male (female) averaged 64.5 (68.6) years in Indonesia; 70.8 (75.5) years in Malaysia; 68.1 (72.4) years in Philippines; 66.0 (73.7) years in Thailand; and 76.7 (80.5) years in Singapore (United Nations, 2005).

Population ageing on the other hand refers to the proportion of the total population which is aged, i.e. over 60/65 years. In 2005, population over 60 years was low in countries like Philippines (6.2 percent), Malaysia (7 percent), but relatively high in Indonesia (8.4 percent), Thailand (10.25 percent) and Singapore (12.2 percent) (United Nations, 2005). As women live longer than men on the average, but usually have lower exposure to labor force and earn less than men on the average, the gender issue is intricately a part of social security issues which need to be addressed.

[3] In this paper the terms social security, retirement financing, and pensions are used interchangeably.

[4] Longevity risks concerns the probability that accumulated savings and retirement benefits may be inadequate to last until death. Inflation risk concerns the probability that value of retirement benefit may not be protected against inflation during the retirement period.

[5] Pension experts generally recommend a replacement rate, i.e. ratio of retirement income to pre-retirement income of between 66 to 75 percent, adjusted for both longevity and inflation risks. Some countries index wages to enable retirees to participate in increased productivity of the nation.

[6] It is particularly important to not compare the existing imperfect systems with a reform options based on implicit assumptions of perfect implementation, no political compromises on design and governance, and benign domestic and international economic environment (Diamond, 2004).

[7] In particular, it should be emphasized that there is no distinct East Asian (or Asian) welfare state model. Standard analytical concepts and discussions can explain widely varying practices concerning social security systems in these countries. Those who espouse distinctness or exceptionalism for East Asia (or Asia) are advancing ideological positions which have no empirical support.

[8] Under the Defined Benefit (DB) method, benefits to be provided to members are defined, and contributions therefore are left undefined. The pension plan sponsor (employer, government, etc.) bears the investment and other risks. DB-type voluntary occupational pension plans are usually not portable (for example, when a person changes jobs), thereby impacting labor mobility. This is also the case with the civil service DB pensions. In mandated social insurance systems, society as a whole bears the risks, and portability issue is not relevant.

Under the Defined Contribution (DC) method, contributions are defined, but benefits are not. It is the individual members who bear investment and other risks, and not the plan sponsor.

[9] The informal sector covers a substantial proportion of the economy in the Southeast Asian countries. In 2000, above half of the labor force were engaged in the informal sector in Thailand (52.6 percent), while in Malaysia and Philippines it was relatively lower at 31.1 percent and 43.4 percent

respectively. Singapore's informal sector is small, and therefore only 13.1 percent of the labor force was engaged in the informal sector in the same period (Asher, 2002).

[10] It is however costly to address the inflation risk fully on a universal basis. Public policies therefore should be directed towards addressing the inflation risk as far as it is fiscally and economically prudent to do so. But these should not be used as an alibi to escape responsibility.

[11] However, in both Malaysia and Singapore, the real rate of return credited to members is less than the real rate of growth of wages, or its proxy GDP. This implies that the replacement rate will be low. Thus, in Singapore, during the 1987-2004 period, real wages grew at an annual rate of 5.9 percent, but real rate of return of the CPF members was only 1.2 percent (Asher, 2004). Author's calculations suggest that real annual rate of return of 3.39 percent in Malaysia for the 1990-2004 period was much lower than corresponding real GDP growth of 6.25 percent, since real GDP can be regarded as a proxy for real wages. The replacement rate in Malaysia is also expected to be low. It is instructive to note that neither provident fund has felt it appropriate to provide the expected replacement rate that members at different income groups can actually expect.

[12] The market capitalization of the Kuala Lumpur Stock Exchange is around RM 450 billion, but the EPF alone has balances of nearly RM 250 billion. The EPF balances are expected to grow more rapidly than stock market capitalization.

[13] The income, wealth, inheritance, and other applicable taxes for provident and pension funds deserve much more emphasis than they have received in this period. This is usually a neglected area of research in the literature.

[14] The Philippine government may consider making actuarial evaluation of the GSIS public to enhance credibility and generate more informed debate. The SSS should also be required to take similar steps.

[15] With appropriate adjustments for local conditions and context, the administrative efficiency indicators of these two countries, especially Malaysia could be used as benchmarks by other countries in Asia.

[16] For the January-September 2003 period, operating expenses of the SSS were 11.3 percent of contributions and 2.0 percent of assets (http://www.sss.gov.ph). A partial reason for the higher ratios in Philippines is the comprehensive set of social protection provided by the SSS.

[17] This is stated in a speech titled "Why SSS is fighting its own Retirement" by Chief Actuary of the SSS (http://www.sss.gov.ph)