Pension crisis looms in emerging Asia

Many emerging Asian economies will likely face a pension fund crisis by 2030 if they fail to set aside sufficient money in a gradually aging region to care for their elderly.

The fiscal burden of public pensions in most Asian emerging economies is relatively small, reflecting comparatively young populations and limited coverage of the retired-age population, which has traditionally been left to families to handle.

Nonetheless, these conditions are likely to change dramatically in the coming decades.

First, many Asian economies will face rapidly aging populations, which will raise pension and other age-related spending dramatically. Second, as economies develop, political pressures to expand the coverage of public pensions and raise benefits will likely increase.

Despite this daunting prospect, there have been relatively few studies of forecasts of public pension spending by emerging Asian economies.

The Organisation for Economic Cooperation and Development, or OECD, has published extensively on the prospects for member countries, but in Asia it has so far only looked at Japan, the Republic of Korea, the People's Republic of China, or PRC, India, and Indonesia.

The International Monetary Fund—the IMF—has only covered seven emerging Asian economies on this issue—the PRC, India, Indonesia, Malaysia, Pakistan, the Philippines, and Thailand.

The Asian Development Bank Institute—ADBI—looked more closely at the extent of the looming pension crisis to identify the current status of public pension spending in Asia; develop models to explain public pension spending in Asia in terms of basic economic and demographic variables; and use the models to forecast the likely developments in spending on public pensions in 23 emerging economies through 2030 as a result of demographic and income trends.

ADBI wanted to recommend policies to expand the financial capacity to cover such expenditure increases, including making social insurance programs more efficient; improving the balance of revenues and expenditures, implementing more explicit fiscal rules, and establishing stronger national and regional fiscal surveillance.

It is the widest pension study so far, covering 23 emerging Asian economies—far more than previous studies.

ADBI models changes in the pension coverage ratio—that is, those eligible for benefits, and changes in average pension benefits—using the latest data from the ADB Social Protection Index database and World Bank Pension database.

Public pension spending in most emerging Asian economies is relatively small, but there are reasons to believe that they will increase spending in the coming years. First, many

Asian economies' populations will be aging rapidly, which will dramatically raise pension and other age-related spending. Second, as economies develop, political pressures to expand the coverage of public pensions and raise pension benefits will increase.

Government spending on public pensions varies widely.

Japan spent 11% of its gross domestic product in 2013 to fund public pensions. It is already wrestling with the problem of a rapidly aging population.

But most emerging and even developed Asian and Pacific countries spend less than 1%. Afghanistan, Bangladesh, Bhutan, Cambodia, Fiji, India, Indonesia, the Republic of Korea, the Lao People's Democratic Republic, Malaysia, Nepal, Pakistan, Papua New Guinea, the Philippines, Samoa, Tajikistan, Thailand, Tonga, and Vanuatu all fall into this camp. The PRC and Viet Nam spend less than 3%.

One reason for the low spending is that these countries' populations are relatively young. This is seen in the ratio of the aged population (65 years and over) relative to the working-age population (15 to 64 years).

Japan's ratio is at 35%, while the Republic of Korea's is at 16%. In contrast, most emerging Asian economies' ratios range from four-to-ten per cent.

With the region's rapidly aging population, this ratio is expected to rise to more than 20% in a number of countries by 2030, including the PRC, at 48%, Thailand (40%), with Armenia, Georgia, Viet Nam, Azerbaijan, India, Malaysia, Kazakhstan, Mongolia, Nepal and Uzbekistan all in the range of the high thirties to the low twenties.

The IMF estimates that many emerging economies will face large increases in public spending on pensions and health-care services, with an average increase of 7 percentage points of GDP between 2010 and 2050, due to aging populations.

By 2030, emerging Asian economies will need to increase their pension spending as a percentage of GDP by an average of 3.6 percentage points, with much bigger increases for Uzbekistan, the Kyrgyz Republic, Armenia, Viet Nam, Mongolia, and Azerbaijan. This reflects the combined effects of rapidly aging populations with relatively high growth of per capita GDP.

Better positioned for shoring up increased pension spending are Bangladesh, the PRC, Lao People's Democratic Republic, Nepal, Indonesia, Vanuatu, the Philippines, Tajikistan, Bhutan, Fiji, Cambodia, and Afghanistan.

Emerging Asian economies need to ensure they can finance public pensions by reforming government spending policies, raising revenue, and improving social insurance programs and the way they are administered.

One way to raise revenues is by increasing property taxes and collecting value-added and personal income taxes more efficiently.

Governments can also reduce the costs of social insurance programs, but they need to be prepared to adjust benefits and premiums to make sure the programs and payouts are sustainable and track cost-of-living increases.

Strengthening policies to maintain fiscal discipline is a must. This means sticking to policy decisions to reduce or limit budget deficits, maintain debt ceilings, and keep a close watch on spending.

Even poor countries can provide a basic level of social protection. To avoid a pension crisis, governments must act early to strengthen their social protection systems and provide adequate support for their aging citizens when needed.

This has been a summary of an ADBI working paper, Costs and Potential Funding of Expanded Public Pension Coverage in Asia, by ADBI's co-chair of research, Peter Morgan, and project consultant Long Trinh.

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