Global Agenda Council: Sustainable Social Security Systems

October 8, 2013
Rising Global Challenge to Provide Sustainable Social Security Systems

Defining Social Security: The GAC definition of social security encompasses a broad interpretation of security in old age, including financial security, health care, and long-term care. Potential solutions include government-sponsored, employer, and private sector programs, as well as more individual savings and different attitudes towards life-time employment.

Global Dilemma: How can developed and developing nations provide financial security for their populations, including retirement security for aging populations and economic opportunity for younger generations?

Current challenges:
• Increase in life expectancy
• Fiscal unsustainability of many retirement and social protection programs
• Decline of social protection programs and employer-provided defined benefit programs
• Increased role of individual responsibility – but many individuals have limited ability to make informed financial decisions
GAC Process

• **Timeline:** The World Economic Forum convened the GAC in the fall of 2012. The GAC will exist for two years.

• **Members:** The GAC has 15 members from corporations, academic institutions, and government agencies from around the world.

• **Meetings:** The group met at the Summit on the Global Agenda 2012 from November 12-14th in Dubai, United Arab Emirates. Since the conference, the group has held bi-monthly virtual meetings.

• **Goal:** To develop a framework for creating sustainable social security systems that is applicable to both developing and developed nations.
## Members

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Setting the Context

Since every economy is different, there is no single solution for creating a sustainable social security system. However, there is a common series of considerations that all economies should take into account when evaluating their individual system.
Setting the Context

• Political economy
  – One size policy solutions will not fit all economies. The state of a nation’s economy and the nature of its political agenda set the stage for its social security system.
  – Countries recovering from the financial crisis face particular challenges.
  – A critical ongoing challenge is how to make pensions sustainable over the long term.

• Rule of law
  – Strong rule of law is necessary for citizens to trust their governments and for businesses to operate effectively.

• Balance between family, the state, and society
  – A strong civil society supports a strong social security system.
  – The state can develop policies and laws that strengthen society, family, and community connections rather than weaken them.
Setting the Context

• Fiscal system and philosophy
  – Sustainable society security systems are formed on the basis of five actors:
    • Activity of citizens
    • Budget
    • Social insurance
    • Charity, including community self-organizing
    • Foreign and international humanitarian aid
  – Underdeveloped countries, middle developed countries, and developed countries generally balance these financial actors in different ways.

• International institutional framework
  – A wide number of global institutions are currently working to build global social security.
  – There is growing academic study and interest in sustainable social security systems.
A Framework for Sustainable Social Security Systems

1. Role of work
2. Financial literacy of the population
3. Private sector tools
4. Functioning capital market
5. Existence of a public floor and adequate social security scheme
6. Tools to manage demographic reality
7. Mobility of social security system
8. Coherence and flexibility of social security system
1. Role of Work

Work is the best form of social security, so people should be enabled to work longer as life expectancy increases.
Role of Work

**Why important:**
• Working longer provides several benefits:
  – Individuals increase current income
  – Individuals delay enrollment in entitlement programs
  – More time for money in defined contribution plans to accrue interest
  – Shortens the length of time that individuals spend in retirement

**How to strengthen:**
• Increased workplace flexibility and enabling workplace practices
• Address cost barriers of hiring/employing older workers (such as health care costs and retirement program costs)
• Implement progressive laws that enable employees to work longer
• Ensure gender equality and workplace participation of women
2. Financial Literacy of the Population

Individuals have begun to assume greater responsibility for their financial security, making financial literacy an imperative.
Financial Literacy of Population

**Why important:**
- Pensions are complex and difficult to understand
- Individuals do not have the benefit of “learning by doing” because they go through retirement only once
- Individuals may have unrealistic expectations of the public pension system
- Very few people make the connection between the number of years they are likely to be retired, the number of years they will be working, and the amount they need to save out of their working wages to fund this retirement

**How to strengthen:**
- Develop realistic expectations of what people can do
- Design a simple system with customers in mind
- Nudge responsible behavior through well-designed defaults and laws to protect customers
- Government/agencies support individuals by taking on the role of an impartial actor
- Create programs to teach financial literacy from young ages
3. Private Sector Tools

Financial markets and employers should help manage the risks associated with retirement saving.
Private Sector Tools

Why important:
• Employers play a critical role in facilitating an individual’s participation in pension systems
• The shift away from government pay-as-you-go systems (pillar 1) to pillar 2 (defined benefit/defined contribution plans) and pillar 3 (individual savings) exposes individuals to substantial risk
  – Financial market risk
  – Longevity risk
  – Inflation risk
  – Business cycle risk
  – Risk of fraud and mistakes

How to strengthen:
• Ensure that attractive pensions are available to the whole workforce
• Develop asset and risk management tools
• Ensure appropriate regulation to protect interests of customers and build trust in financial institutions
• Embed domestic regulation in international architecture to allow for cross-border cooperation
• Incentivize long-term saving
• Pool and diversify risk across populations and geography
• Enable efficient use of home equity
4. Functioning Capital Market

Deep, broad, and liquid capital markets are necessary to support strong financial retirement and social security systems.
Functioning Capital Market

Why important:
• Financial stability is necessary for the sustainability of retirement programs
  – In advanced market economies, stability rekindles growth
  – In developing economies, stability induces/sustains financial growth
• A functioning market will prevent or mitigate future financial crises
• Deep liquid capital markets allow the private sector to develop tools to enable asset-liability matching and to hedge risks, which in turn can lead to more investment choices for institutional and retail investor, thus improving long-run retirement saving opportunities

How to strengthen:
• Regulatory framework to ensure competition in all sectors and enforcement of legal/property rights
• Policy to create deep liquid government bond markets on which private bond markets can be based; policies to encourage private equity, IPOs, and well-regulated stock markets
• A deep and liquid national capital market (in addition to banks) to help mobilize national savings for the nation’s development needs
• Better economic policy coordination to detect and reduce macroeconomic imbalances that threaten the health of the global economy
5. Existence of a Public Floor and Adequate Social Security Scheme

A public floor is an enabler, as it guarantees income security and access to basic services throughout the life course.
Existence of a Public Floor and Adequate Social Security Scheme

**Why important:**
- Effective method to reduce poverty and inequality
- Stimulates formal workforce participation and inclusion in the tax system
- Has an income-redistributive effect from time spent working to time spent in retirement
- Provides savings for the individual and the state
- Low administrative costs compared to private sector schemes

**How to strengthen:**
- Close coverage gap by providing a form of basic protection for all
- Ensure adequate income replacement rate in the future
- Decide where to position social security benefits in relation to the minimum living wage
- Built-in stabilizers (e.g., indexation to longevity) to ensure that the system will follow economic and demographic developments
- Centralized, transparent, and efficient administrative and funding structures
6. Tools to Manage Demographic Reality

Both well-established and newly created social security systems must confront challenges of demographic aging and fiscal instability by strengthening proactive and preventive social security measures.
Tools to Manage Demographic Reality

**Why important:**
- Dependency ratios (the number of retirees to the number of workers) are rising
- Rising public expenditures on old-age pensions put stress on other government responsibilities, including health and education
- Countries with a growing number of older people are looking to gradually increase retirement age and extend time spent working
- Migration and birth rates also contribute significantly to demographic change

**How to strengthen:**
- Infrastructure adjustments
  - Affordable old age care, including disease prevention and wellness
  - Accessible public spaces and transportation
- Migration policies
  - Search for immigrants with needed skills
  - Integrate immigrants quickly and effectively
- Family policy that increases support of parents and children
- Labor market that ensures gender equality and work participation of women and increases lifetime employment
7. Mobility of Social Security System

As people increasingly move across employers, across nations and from rural to urban areas, it is important to develop portable social security systems.
Mobility of Social Security System

Why important:
• People are increasingly moving
  – across employers
  – across nations
  – from rural to urban areas
• Portability of entitlements is currently limited to a few regions and is not even portable between urban/rural environments in some countries

How to strengthen:
• Facilitate mobility from one employer to another within a country
• Develop mobility across nations to enhance human migration
• Consider mobility within and to the middle class
• Address mobility from rural to urban areas and tie to formal/informal social security systems
8. Coherence and Flexibility of Security System

How the different pillars work and fit together is critical to underpinning basic income security in old age.
Coherence and Flexibility of Security System

**Why important:**
- Some systems currently do not have the flexibility to adapt to changing demographic and economic patterns.
- States need to provide a basic floor but society, families, and the individual all have their roles, and these structures need to work together.

**How to strengthen:**
- Develop systems with the flexibility to adjust to major trends that are changing the nature of societies:
  - Demographic aging
  - Eligibility benefits tied to work incentives
  - Life-long learning
- Support informal social security in societies.
Questions for Discussion

1. What are appropriate retirement ages -- minimum, targeted, and maximum -- given representative lifespans and health spans and desired productivity of the population?
2. What are the advantages/disadvantages of advanced funding vs. pay-as-you-go systems?
3. What is the desired level of total financial support (income) for retirees?
4. What is the desired proportion of the total income that is funded by individuals, employers, and the government?
5. What needs can be met by family and society? What solutions benefit citizens of all ages, not just the elderly?
6. How can we transition from the current state to the desired state?
7. What are the risks associated with various pillars for retirement funding?
8. What are the pros and cons of employer-based pension systems?
9. How much should countries spend on the elderly relative to children?