INDEPENDENT EVALUATION GROUP

IEG REACH

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Based on the OED *Bank Assistance to Pension Reform and the Development of Pension Systems.*

Pension Reform: How to Strengthen World Bank Assistance

- The Bank has been a leader in pension reform, providing extensive financial and technical support to many countries. The Bank's strategy supports a flexible, multi-pillar framework, under appropriate macroeconomic, social and financial conditions. The Bank has assisted both pay-as-you-go (PAYG) and multi-pillar pension systems, although much lending and non-lending work has focused on countries implementing multi-pillar reforms.
- In countries in which initial multi-pillar conditions were not in place, the Bank generally supported purely PAYG reforms. Nonetheless, in a number of instances, the Bank supported multi-pillar reforms even though there were clear weaknesses in the country's underlying economic and financial structure. Moreover, the Bank did not always fully consider non-contributory options to expand the social safety net to the populace outside the formal system.
- Bank-supported reforms often have contributed to fiscal sustainability. But, despite expectations, in many countries with multi-pillar systems, funded pensions remain poorly diversified and pension coverage has not increased. In addition, the secondary objectives of funded pillars—to increase savings, develop capital markets, and improve labor flexibility—remain largely unrealized.
- The evaluation recommends the development of guidelines to ensure that assistance is well-tailored to country conditions and argues that more attention needs to be paid to building institutional capacity if reforms are to be sustainable.

Background

Formal pension systems constitute an important means of reducing poverty among the aged. Pension reform has become pressing, as demographic aging and lax benefits have strained pension finances. Pension systems have become a source of macroeconomic instability, a constraint to economic growth, and an ineffective and/or inequitable provider of retirement income.

The Bank's Role

In the 1990s, the World Bank took a leading role in pension reform. The World Bank's strategy for pension reform is formalized in *Social Protection Sector Strategy: From Safety Net to Springboard* (*Strategy*), which sets forth a multi-pillar framework consisting of: (1) a publicly managed, tax-financed pension system; (2) a privately managed, funded scheme; and (3) voluntary retirement savings. *Strategy* followed up on the World Bank's earlier policy research report, *Averting the Old Age Crisis* (1994), which offered a more detailed prescriptive exposition of a multi-pillar pension framework. This report gained prominence worldwide as favoring funded systems and provided the underpinning for much of the Bank's activities.

The Bank has supported a wide variety of pension reforms through lending operations and analytical and advisory services. Bank operations also helped countries build institutional capacity to strengthen the administration of tax-financed pension systems and the regulation of funded pensions.

Since 1984, the Bank assisted 68 countries reform their pension systems through more than 200 loans and credits (Table 1). In addition, the Bank issued over 350 papers and publications on pension reform. The Bank offered relatively more assistance to multi-pillar reformers.

Table 1: ECA and LAC received more support than other regions for pension reform from FY1984 to FY2005

Region	No. of Countries	No. of Projects	Commit-ments ($ bn)	Size of Pension Comp ($ bn)
AFR	14	26	$1.5	$0.1
EAP	4	7	$7.4	$0.5
ECA	25	93	$10.8	$1.5
LAC	15	57	$10.7	$3.1
MNA	6	9	$1.1	$0.1
SAR	4	12	$2.7	$0.1
Total	68	204	$34.2	$5.4

Key Lessons and Findings

Eighty-seven percent of all projects with a pension component and 75 percent of the pension components themselves were satisfactory in terms of their evaluation outcome. However, OED case studies analyzing the longer term impact of the reforms found that outcomes varied widely across countries and depended on the depth of analyses and initial conditions, institutional capacity and political commitment.

Most frequently, the Bank's interest in pension reform was sparked by concerns about fiscal sustainability, but, in so doing, the Bank frequently neglected the primary goal of reducing poverty and improving retirement income adequacy *within a fiscal constraint*.

The Bank's breadth of research on pensions is impressive, covering a broad range of topics. But economic and sector work (ESW) often lacked the analytic depth needed to support project preparation. Fiscal and regulatory issues, in particular, have been the focus of substantial analysis. However, analyses of the living conditions of the aged tended to be perfunctory, and few studies have empirically investigated the limits of formal pension coverage or ways to increase it.

The Bank's strategy for a multi-pillar pension system relies on ensuring that a number of initial conditions are in place, including sound macroeconomic policies and an adequate financial sector. In countries in which initial multi-pillar conditions were not in place, the Bank most often supported purely PAYG reforms. Nonetheless, in a number of instances, the Bank supported multi-pillar reforms even though there were clear weaknesses in the country's underlying economic and financial structure. Moreover, the Bank did not always fully consider non-contributory options to expand the social safety net to the populace outside the formal system.

While the impact of pension reforms takes years to discern, OED used indirect indicators to gauge the long-run effectiveness of the Bank's support. Bank-supported reforms have often contributed to fiscal sustainability. But, despite expectations, in many countries with multi-pillar systems, funded pensions remain poorly diversified and pension coverage has not increased. Also, the secondary objectives of funded pillars—to increase savings, develop capital markets, and improve labor flexibility—remain largely unrealized.

Recommendations

This evaluation has several recommendations. First, to ensure well-tailored assistance to country conditions and consistent policy prescriptions, the Bank needs to implement guidelines for Bank staff for the development of pension operations, paying more attention to the minimum macroeconomic and financial sector preconditions necessary for a multi-pillar reform. It also needs to not oversell the benefits of the secondary objectives of pension reform in its dialogue with client countries.

Second, to ensure that client capacity to implement pension reform is adequate, the Bank needs to develop a checklist for capacity requirements and provide increased assistance for building capacity.

Finally, the evaluation also recommends that the Bank: conduct additional research on high priority issues, such as income of the aged, the impact of corruption and governance on the feasibility of effective pension regulation, methods to foster competition among pension funds, guidelines for investment allocation, the design of noncontributory systems, and ways in which to stimulate capital market development.

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