Overview of Retirement-income Systems

Retirement-income regimes around the world are diverse and they often involve a number of different programmes. As a result, classifying pension systems and different retirement-income schemes within those systems is difficult. Perhaps the most well known of these taxonomies is the "multipillar" one of the World Bank (1994). In its current versions, this comprises five different pillars (Holzmann and Hinz, 2005). The focus of this report, however, is on mandatory retirement-income provision and so some of these pillars are not necessary here.

The framework consists of two mandatory "tiers": a redistributive part and an insurance part. The redistributive part is designed to ensure that pensioners achieve some absolute, minimum standard of living. Insurance components are designed to achieve some target standard of living in retirement compared with that when working.

The focus of the pension modelling is on workers that are covered by formal-sector pension schemes. The analysis of the structure of pension systems in Table 1, therefore, only covers retirement-income programmes relevant to this group. More general safety-net benefits, often called social pensions, are not therefore covered in the table (see Palacios and Sluchynsky, 2006, on such schemes).

Starting with the first tier, all the OECD countries have redistributive schemes that affect some or all workers with full careers in the pension system. In contrast, only a third of the Asia/Pacific economies outside the OECD have comparable provisions.

The most common kind of redistributive scheme in the 21 economies as a whole are resource-tested programmes, which grant a higher payment to poorer pensioners, with the amount reduced as the level of other income during retirement increases. The most important of these types of scheme in a national context is the Australian plan, but these also play a significant role in providing retirement incomes in many other OECD countries and Hong Kong.

Minimum pensions are similar to resource-tested schemes, in that they pay a higher benefit to lower-income retirees. However, the crucial difference is that the value of the entitlement depends only on income from a particular pension scheme and not income as a whole (including capital income, earnings, rents, etc.). Normally they are provided as part of the earnings-related pension scheme, whereas resource-tested schemes are institutionally separate. There are minimum pensions in the Philippines and Pakistan.

The third type of first-tier pension is a basic scheme, in which the amount paid is either a flat rate or it depends on the number of years of contributions; it is not dependent on individual earnings. For example, the basic pension in China pays a fixed percentage of average, city-wide earnings for each year of coverage. The pension system of Korea has a similar basic component: the pension is based on a mix of individual and economy-wide earnings.

Table 2. **Structure of pension systems**

	First tier Universal coverage, redistributive			Second tier Mandatory, insurance	
	Public			Public	Private
	Resource tested	Basic	Minimum	Type	
East Asia/Pacific					
China		●		DC	
Hong Kong, China	●			DC	
Indonesia				DC	
Malaysia				DC	
Philippines		●	●	DB	
Singapore				DC	
Thailand				DB	
Viet Nam				DB	
South Asia					
India				DB + DC	
Pakistan			●	DB	
Sri Lanka				DC	
OECD Asia-Pacific					
Australia	●				DC
Canada	●	●		DB	
Japan		●		DB	
Korea		●		DB	
New Zealand		●			
United States	●			DB	
Other OECD					
France	●		●	DB + points	
Germany	●			Points	
Italy	●			NDC	
United Kingdom	●	●	●	DB	

DB = defined benefit.
DC = defined contribution.
NDC = notional defined contribution.
Source: OECD pension models.

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The second tier in this typology of pension schemes plays an “insurance” role. These plans play a particularly important role in retirement income systems outside of the OECD countries because of the relatively limited extent of redistributive schemes. They are designed to provide an adequate income relative to previous earnings, rather than just providing a minimum living standard (as with the first tier). Again, they are mandatory.

Seven of the eleven non-OECD economies have a defined-contribution (DC) plan, where the contributions are saved over time and either paid as a lump sum or as pension-income stream at retirement. The remaining four economies, as well as India which has both, all have defined-benefit (DB) schemes. In these plans the amount of income received at retirement is dependent on the number of years of contributions and on the level of individual earnings.

There are also notional-accounts (NDC) schemes: the public pension in Italy is the only example listed. This scheme records each worker’s contributions in an individual account and applies a rate of return to that account. The accounts are “notional” in that both the incoming contributions and the interest charged to them exist only in the books of the

managing institution. At retirement, the accumulated notional capital in each account is converted into a stream of pension payments using a formula based on life expectancy.

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