



Enhancing Mongolia's Pension System

The state pension system was established under the Social Insurance Law of 1994 and is one of the five major programs in social insurance. The Ministry of Social Welfare and Labor (MSWL) is mainly responsible for formulating pension policies while the State Social Insurance General Office (SSIGO), under MSWL, is responsible for implementing the pension scheme including collection of premiums and payment of benefits. The pension fund and other state funds are not independent from the treasury function and the Ministry of Finance (MOF) is responsible for managing these funds.

In terms of coverage, public and private sectors employees and the self-employed, including herders, are subject to different pension schemes, and the fund is managed on an aggregate basis. The pension system currently operates on a pay-as-you-go basis. Each year's contribution income is used to finance benefit payments due during the year. It is estimated that the scheme has an annual deficit of about \$37.7 million and is expected to balloon in the near future with the growth of benefit payments exceeding that of the collected pension premiums.

A legislation adopted in 1999 set out a computation of pensions which stated that for workers born after 1960, the amount that each individual contributes toward one's pension is accumulated in his/her own retirement account. The individual will receive a monthly pension equivalent to the balance in his account divided by his expected life at the time of his retirement. However, the scheme was not followed as intended. The contributions for each year under the new system is not accumulated and invested but instead used to finance the same year's benefit payments.

Preliminary estimates showed that underfunded pension obligations reached 200 billion Mongolia togrog

(MNT), about 7%–8% of the gross domestic product (GDP) in 2005. This is expected to spiral further to MNT40 billion–50 billion per year. The growing problem in the funding sustainability of the pension scheme may cause fiscal instability in the country, hence the need to address the problem. Various ways have been identified to help enhance the pension fund's viability, including improving the contribution collection rate, encouraging the participation of eligible workers, developing better coverage in terms of type of workers and benefits, and reviewing the sustainability of the current pension benefit policies, including pension fund restructuring, among others.

As a response, MSWL drafted a law to increase the collection rate, expand the coverage of the pension system, raise the retirement age, and allow the pension fund to invest in financial products. The implementation of the law is expected to contribute on improving the sustainability of the pension system. As a long-term goal, the government has envisaged the development of the pension system into a three-pillar system:

- the first pillar as a basic pension for maintaining basic life,
- the second pillar in proportion with the salary and contribution level, and
- the third pillar as a voluntary pension scheme and supplementary pension insurance products.

The technical assistance is expected to establish a restructured pension system that is adequate, affordable, self-sustaining, and operationally effective.

Strengthening the Pension System

With some of the ground work already drawn up, the Government of Mongolia requested the Asian Development Bank (ADB) for technical assistance (TA)¹ to support the strengthening of its pension system. The TA was expected to establish a restructured pension system that is adequate, affordable, self-sustaining, and operationally effective that will be adopted by the government.

Toward its goals, the TA supported the review of the current pension policies, practices, and existing plans for pension reforms, identify the merits and gaps, and recommend a strategy for further pension reforms. Specific activities conducted include the:

- review of current policies and practices on pension contributions and benefit payments and operations of the pension system;
- review of the progress of pilot programs extending the coverage to the self-employed and herders;
- assessment of the affordability of pension premiums for existing and potential contributors and adequacy of meeting the retirees' basic needs;
- review of MSWL's plans for pension reforms reflected in the draft law from the viewpoint of adequacy, affordability, self-sustainability, and operational efficiency;
- review of enforcement measures for collection and SSIGO's practices and institutional capacities in premiums collection and personal account management;
- review of other countries' experiences in moving from a pay-as-you-go system to a national defined contribution system, and in the development of a three-pillar pension system in selected countries to extract lessons and identify models;
- proposal of a strategy to further reform the pension system;
- assessment of the impacts, both positive and negative, of the pension reforms on vulnerable people;
- proposal of a road map to develop a three-pillar pension system; and
- identification of need for additional external assistance to implement the strategy to further reform the pension system.

Furthermore, the project also looked at alternatives on how to better manage the pension funds and studied potentials of financial products as investment tools. It has assessed current market conditions and the potential markets of various financial products; reviewed legal and regulatory environment and other infrastructure supporting the financial products; reviewed staff capacities and institutions in charge of managing pension funds and other state funds, and of the private sector; and proposed policies and guidelines on investment and portfolio management for restructured pension funds.

The legal environment was also deemed important to effectively implement the recommended pension reforms and facilitate the pension fund's investment and management activities. The project supported activities toward the review of existing legislation and regulations governing pension policies and operations, MSWL's draft amendments to the laws, and those that may affect the pension fund's operations and investment activities after restructuring. It assisted in the drafting of legal amendments to implement the further reform strategy and facilitate the investment activities of the pension fund.

Part of the assistance was to increase public awareness on the benefits of the pension system and the importance of pension reforms. Workshops and conferences were organized to disseminate the project's findings and recommendations and lessons from the experience in other countries to various stakeholders and invite comments from them. Training activities for operational staff were also conducted on measures to improve efficiency, for fund management staff of the pension fund and other institutional investors on investment policies and portfolio management, and for actuarial practitioners on actuarial calculation. In addition, a short-term study tour for key government officials was organized to learn from the experience in pension reforms in another country, which can serve as a model for Mongolia's pension reforms.

Endnotes

¹ Asian Development Bank (ADB). 2006. Technical Assistance Report on Mongolia: Strengthening the Pension System (TA 4910-MON). Manila. The total cost of the technical assistance is estimated at \$770,000, where ADB administered a portion of technical assistance not exceeding \$500,000 financed by the Government of Luxembourg on a grant basis. ADB provided the balance of \$150,000 on a grant basis to the Government of Mongolia for Strengthening the Pension System or a total of \$650,000. The Government of Mongolia financed the remaining \$120,000 local currency equivalent in kind, to cover office accommodation, counterpart staff, and other related services.

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