1 Introduction

Singapore is "a" welfare state in its own right because of the "government-made" developmental state which had enabled its transition from third world to first in some three decades (Low, 1998 and Low, ed, 1999). The authoritarian and paternalistic style of the People's Action Party (PAP) has been in continuous power since 1959. Its socialist predilection was at least, in distribution policies via education, health and housing, leaving the economy largely capitalist and market-driven. Embedding social goals in the political economy ensured stakeholdership in housing and other assets among a migrant stock of people. A 1955 legacy from British colonial rule, the Central Provident Fund (CPF) has gone over and beyond old age social security. It may even have compromised traditional social protection to a certain extent (Low and Aw, 1998).

The CPF model has to be reinvented and reengineered like the rest of Singapore Inc and its government-linked companies (GLCs) in the new economy of globalisation, information communication and technology (ICT) and knowledge-based economy (KBE) which Singapore is propelling toward. The developmental state ensemble had served the old brick-and-mortar economy based on factor productivity and efficiency of infrastructure in a stable and effective administrative state. Specifically, the CPF model is successful as long as full employment is the operating assumption. There is greater interdependence and volatility in the global economy, and KBE needs creative and innovative intellectual capital, not mere human resources development (HRD). Real and unaccustomed issues like episodal unemployment, unemployability, job insecurity and inequity with the digital divide have surfaced. Policy-makers have to maintain a competitive economy while an ageing demography needs stronger pillars of social security and welfare protection.

Section 2 gives a brief overview of the political economy origins and evolution of social security while Section 3 delves into CPF schemes for old age income security and maintenance. In evaluating how CPF differs or has certain merits over other welfare states, Section 4 raises issues, challenges and policy responses. The conclusion and policy findings may be too unique in a paternalistic city-state to have much relevance for other developing states. But how Singapore approached basic social security needs and problems common to all countries may be germane especially in some CPF schemes and operations.

2 Political economy background and evolution

From third to first world

Literature is extant on Singapore's transition from third world to first (like Bercuson, et al, 1995), no less senior minister Lee Kuan Yew's memoirs (Lee, 1998 and 2000). In its holistic approach to transform an entrepot economy to a high technology, high skilled and high value added manufacturing-service hub, the PAP government has been unapologetic about the way it commandeered resources. It acquired land cheaply for infrastructure including public housing via the Land Acquisition Act, reshaped demography, equipped labour via HRD and continuous education and training (CET) and mobilised domestic capital via CPF saving and other forms of public sector surpluses beside attracting direct foreign investment (DFI). The resultant developmental state promoted long term entrepreneurial perspectives among the industrial elite comprising mainly those from multinational corporations (MNCs) and GLCs. It was not till the
late 1970s that small-medium-sized enterprises (SMEs) were nurtured as a third leg, emerging as promising local enterprises (PLEs) by the early 1990s. Formulated on meritocracy, technocracy and a disciplined bureaucracy, Singapore Inc and its GLCs prioritised production over consumption-based goods, engineered and institutionalised links with the business elite through consultative arrangements or control of key resources.

What distinguished Singapore Inc from other developmental states was its strict resistance to growth-compromising demand from special interest groups. Ironically, its lack of natural resources and options after its separation from Malaysia in 1965 forced it to solve its economic and socio-political ethnic problems through outward-oriented competitive strategies rather than insular, protective ones. There is some intrinsic, implicit correlation between a developmental state and industrial policy on one hand, and authoritarianism and democracy on the other. Industrial policy is not an alternative to the market but the state intentionally alters incentives within markets to influence behavior of producers, consumers and investors. Neither is a developmental state an alternative or displacement of the market nor synonymous with authoritarianism. But an elective affinity exists. A strong state and bureaucracy as in Singapore has been legitimised by its more experimental, undocinaire approach especially as a late industrialiser playing catch-up. The situation was further exploited by PAP seizing a crisis mentality especially in the 1960s and 1970s.

Today, Singapore topped a new globalisation index (Foreign Policy, January/February 2001) driven largely by technology, especially Internet access. Next to it are other small countries including Netherlands, Sweden, Switzerland, Finland and Ireland. In contrast, a study by Global Entrepreneurship Monitor, a joint research venture between London School of Business and Babson College, Massachusetts partly funded by Singapore's National Science and Technology Board (NSTB) ranked Singapore near the bottom. The hard truth is the government has cultivated a generation of followers rather than creative innovators (International Herald Tribune, 24-5 March 2001, p 24). Whether Singapore's paternalistic developmental state through Singapore Inc is sustainable in the new globalised KBE needs a profound rethink, not withstanding that leadership for a small, open city-state remains imperative. Its 1993 regionalisation policy has leveraged both ICT and KBE to enable the virtual state to increasingly relocate part of its production abroad. Virtualisation allowed specialisation in higher valued, intangible research and development (R&D) products, product design, finance, insurance, marketing, transport, logistics, legal and other professional services, to reshape both productive and international relationships.

The state may no longer be at commanding heights and has to negotiate with domestic and foreign capital and labour. Singapore has to compete based on a mastery of flows of production and purchasing power. Competition is not mere efficient producers with proprietary rights of machines and physical capital but not of stock of intellectual capital which has become mobile across competitive borders. Transformative capacity in particular, is the state's capability to anticipate and respond to economic change, adapt to external shocks and pressures by generating new means to govern and manage the process of industrial change. With its new found wealth, the state has to augment society's investible surplus rather than redistribute existing resources. Thus, social security policy premised and underpinned by HRD objectives in housing, education and health has to heed intensified competitive gear without losing sight of growing inequity, digital divide and ageing demographics.

A basic social security choice: individuals or state
A classic political economy choice always exists between individuals and state taking charge of social security and income protection. Much as the PAP regime dominated economically, it wisely eschewed overt welfarism and social insurance except when social services paid off economic dividends. The general global trend, especially among systems mired with fiscal deficits, has shifted to favour defined contributions and more individual-based social protection for greater transparency and accountability. But greater risks and insecurity in the globalised KBE (Table 1) has made the matter of who has greater foresight, vision and means to pool resources to cope with them more urgent. Less state and more private systems require the necessary and sufficient conditions of financial sector development and sufficient education and sophistication in personal financial management.

Table 3 Types of risks and who bears them

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<thead>
<tr>
<th></th>
<th>Defined benefit</th>
<th>Defined contribution</th>
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</thead>
<tbody>
<tr>
<td>Inflation</td>
<td>Shared</td>
<td>Individual</td>
</tr>
<tr>
<td>Financial return</td>
<td>Shared</td>
<td>Individual</td>
</tr>
<tr>
<td>Interest rates</td>
<td>Shared</td>
<td>Individual</td>
</tr>
<tr>
<td>Recession</td>
<td>Blend</td>
<td>Individual</td>
</tr>
<tr>
<td>Extended illness</td>
<td>Blend</td>
<td>Individual</td>
</tr>
<tr>
<td>Longevity</td>
<td>Shared</td>
<td>Individual, no annuity</td>
</tr>
</tbody>
</table>

Source: Aaron and Shoven, 1999, p 61.

A social state contributes two core democratic values: social responsibility and social justice to complement political democracy including civil rights and liberties. It may intervene on a continuum from nonintrusive to central control. The PAP is not a purist social state and CPF is trying to move from control and public management of mandated saving to merely providing informative, advisory, stimulative directives by preserving free market competition. As a provider-of-the-last-resort, the state ideally intervenes only where market fails, prevents disservices associated with capitalistic enterprise, enforces performance standards through licensing and regulation and guards against fraud (Burch, 1999, pp 218-9).

It is a political call whether the state can delink both CPF schemes (housing, health, education and asset enhancement) from old age social security and availing itself to CPF resources through mandated investment in government securities. CPF is tied to the fiscal process as a political choice. Strictly, chronic budget surpluses mean the government no longer needs to borrow from CPF for deficit developmental financing. With a guaranteed 2.5% interest rate for CPF, there is an implicit taxation as the Government Corporation of Singapore (GIC) which takes care of all public sector and fiscal surpluses can easily earn a higher rate of return (Asher, 1998 and 1999). In defence, CPF members paid 2.5% do not worry about fund management costs, inflation is relatively low and good governance and government have provided sound macroeconomic management and growth. Without any other natural resources, financial resources so garnered into state coffers have funded its transformative capacity, albeit in a high-handed government-knows-best manner.

A blend of a pure economic market (based on ability to pay, consumers expressing wants and suppliers provide through competitive sale to able buyers) and a pure social market (based on need unrelated to ability to pay and subsidised by state or charity) may be more attractive and necessary. Table 2 shows the pure economic and social markets and two hybrids (social market payer/economic market provider and economic market payer/social market provider). Singapore
straddles between the two hybrids, possibly closer to the latter as the prevailing force is always economic competition.

Table 2 Economic and social market

<table>
<thead>
<tr>
<th></th>
<th>Consumers</th>
<th>Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td>Ability to pay and want is enough</td>
<td>Competitive sale to able buyer</td>
</tr>
<tr>
<td>Social</td>
<td>Need unrelated to ability to pay</td>
<td>Subsidised by government or charity</td>
</tr>
</tbody>
</table>


The World Bank three-pillar framework social security is useful tracing the navigation from political economy conditions in the 1960s to today's competitive globalised KBE juxtaposed with an ageing population in Singapore. The traditional welfare, mandatory publicly managed, tax-financed pillar was the weakest by choice given Singapore's lean public assistance schemes. It had always been teaching people to fish (provide and ensure employment) rather than give fish (welfare). The CPF falls under the second pillar though it is publicly managed. Voluntary saving is fairly high over and above mandated CPF saving.

Table 3 Three pillar reformed old age income security systems

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Mandatory pub managed</th>
<th>Mandatory pte managed</th>
<th>Voluntary pillar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectives</td>
<td>Redistrib+coinsurance</td>
<td>Saving+coinsurance</td>
<td>Saving+coinsurance</td>
</tr>
<tr>
<td>Form</td>
<td>Flat, means-tested,</td>
<td>Personal saving,</td>
<td>Personal saving,</td>
</tr>
<tr>
<td></td>
<td>minimum pension</td>
<td>occupational plan</td>
<td>occupational plan</td>
</tr>
<tr>
<td>Financing</td>
<td>Tax-financed</td>
<td>Regulated, fully funded</td>
<td>Fully funded</td>
</tr>
</tbody>
</table>


3 CPF schemes for old age income security and maintenance

With imminent independence, the British inducted self-financing, fully funded provident scheme for its colonies, simple save-as-you-work for old age income security and maintenance. It was only CPF which innovated most extensively and aggressively to house a healthy, educated and wealthy nation (Low and Aw, 1998 and Reutens and Lee, 2000).

The current rate of 30% for employees below 35 years (20%:10% employees and employers, respectively) is paid into three accounts. The Ordinary Account takes 24% for housing, approved investments, CPF insurance, tertiary education and topping-up of parents' Retirement Accounts. For members below 35 years, 6% is put in Medisave, rising for older workers (Table 4). The third Special Account which used to absorb 4% was suspended when the 40% CPF rate was cut to 30% in January 1999 (Table 5). At age 55, members may withdraw saving from Ordinary and Special Accounts after setting aside the mandated Minimum Sum of $60,000 (minimum $20,000 cash, rest pledged with a property). The Minimum Sum will rise gradually by $5,000 a year to $80,000 by 2003. Members are encouraged to buy approved life annuities with this Minimum Sum, deposit with approved banks or leave in CPF.

Table 4 Medisave effective January 2001

<table>
<thead>
<tr>
<th>Age</th>
<th>Contribution rate (percentage points)</th>
</tr>
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<tbody>
<tr>
<td>35 and below</td>
<td>6</td>
</tr>
<tr>
<td>&gt;35-45</td>
<td>7</td>
</tr>
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</table>
Table 5 Special Account effective January 2001

<table>
<thead>
<tr>
<th>Age</th>
<th>Contribution rate (percentage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>35 and below</td>
<td>4</td>
</tr>
<tr>
<td>&gt;35-55</td>
<td>6</td>
</tr>
<tr>
<td>&gt;55</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: CPF.

To encourage employment of older workers to alleviate labour shortage, keep senior citizens active and save more with longer life span, employees above 55 to 60 years and their employers contribute 12.5% and 4% respectively (total 16.5%). For those aged 60 to 65 years, the rates are 7.5% and 2% (total 9.5%), falling to 5% and 2% (total 7%) for those above 65 years. For those 65 and above, the whole 7% goes into Medisave. The maximum monthly contribution for all age groups is based on a monthly salary ceiling of $6,000 for tax exemption purpose. The Retirement Account kicks in under the Minimum Sum Scheme for those over 55 years and have left their saving with CPF. Since July 1998, CPF members below 55 can transfer up to $40,000 from Ordinary to Special Accounts. Both Special and Retirement Accounts earn 1.5% in addition to the minimum guaranteed 2.5%. From 1 July 1999, instead of a six-monthly adjustment, CPF interest rates are revised quarterly bringing them closer to prevailing market interest rates together with a new formula which gives 80% weightage to fixed deposit and 20% to saving deposit given the long term nature of CPF saving.

The diversification or liberalisation of CPF saving started with public housing in 1968, extending to private and nonresidential properties which can also be purchased jointly by family members allowed to pool their CPF saving. From February 1999, CPF members can even use Special Account saving kept strictly for retirement to help meet housing instalment shortfalls arising from the 10 percentage point reduction in employers' CPF contribution (CPF, 2000, p 30). This was the second cut in employers' CPF contribution, the first in the 1986 recession. It reflects how tying macroeconomic stabilisation through wage policy with CPF also geared to home ownership among other political economy objectives can have spillover effects. These have to be sensibly and sensitively addressed since the state endorsed policies which the citizenry has diligently followed.

Following a national health care plan, Medisave was created in 1984 with the current ceiling of $22,000 for those below 55 years and $17,000 for those above 55. Medisave is for approved health care expenses (hospitalisation, hepatitis B vaccinations, chemotherapy, radiotherapy, approved outpatient treatments and approved medical insurance premiums). Though CPF is voluntary for the self employed, Medisave was mandated for them from January 1998 at 8% of annual net trade income for those above 45 years and 6% for those 35 years and below. Medishield is a low-cost national catastrophic insurance scheme for CPF members and dependents. Medishield Plus is for those who want higher coverage.

Other CPF insurance schemes are Dependants' Protection Scheme (term life insurance against permanent incapacity) and Home Protection Scheme (compulsory mortgage reducing insurance). Both are designed to help family members dependent on members' as main income earners.
The most creative extension of social security for old age allowed both CPF balance after the Minimum Sum is met and Special Account saving for CPF Investment Scheme (CPFIS). For all CPF balance, the December 1999 revision increased the limits to be invested in approved professionally managed products such as unit trusts and reduced that for self investing in approved stocks and shares. For Special Account saving, lower risk products include long term bank deposits, deferred annuities, endowment insurance products, Singapore government and statutory board bonds and other bonds guaranteed by government and certain selected unit trusts and investment linked insurance products. Higher risk products representing funds wholly or mainly invested in equities are disallowed. Neither is investment in individual stocks and gold allowed emphasising the message Special Account saving is for capital preservation not punting.

De facto, all Ordinary Account saving including Minimum Sum can now be invested. This necessitates the redefinition of investible saving as total Ordinary Account saving excluding amount withdrawn for housing. The investment limit for stock is set at 35% of redefined investible saving and 10% for gold. The rationale in 1993 to allow profit withdrawal to encourage members to invest their CPF saving was revoked. Higher interest is now deemed not in line with CPF’s objective to enhance old age saving as profit withdrawal from even profitable investment could result in zero enhancement of CPF saving. By October 2002, no profit will be allowed to be withdrawn for ordinary account saving. The CPF has established a Risk Classification System to help members select CPF approved unit trusts.

Some empirical results are revealing. Nearly three in five of the quarter million (56% of 494,725) of CPF members who took advantage of CPFIS in 1999 made less than 2.5%, alluding they would have done with CPF, not try to manage funds themselves (Straits Times, 4 January 2001). Nearly 278,000 members incurred losses after accounting for interest foregone with 67% of them sustained losses of less than $1,000 each and 7% with net losses of more than $5,000 each. Under 95,000 CPF members or nearly one fifth of the scheme’s membership incurred losses outright even before interest was taken into account. The gains of some 207,000 were less than $1,000 each and over 8% or 17,500 made net profits over $5,000 each, under 10,000 made 2.5% or just broke even.

These statistics imply that while the exercise of autonomy and discretion by members in investment according to market regime is generally correct, they may not be as savvy and fully apprised of market conditions as presumed. While liberalising CPFIS, CPF is beholden remain paternalistic with stricter oversight regulations as the market can be volatile and inscrutable. These changes reflect the government’s intention to put old age saving as first priority. Decentralisation of investment from CPF to professionally managed and approved categories seems to soften implicit taxation. There would be some delinking of CPF from the fiscal process but the net effect varies according to members’ choices to leave saving with CPF or use CPFIS. Some will still want to try and perhaps view losses as part of the learning curve so long as their belief in the market and perception of the implicit taxation hold. Politically, the government has signaled somewhat, its accession to such sentiments.

The Supplementary Retirement Scheme (SRS) announced in January 2001 encourages high income groups and foreign workers who were exempted from CPF since 1996 to save in approved income maintenance and security products available in participating banks from April. They are in the nature of US 401(k) accounts with generous tax relief except that employers do not participate in SRS.

Generally, CPF members appear well covered and provided in all aspects of old age income security and maintenance. The national institutionalised CPF system is rather sui generis and distinctive not so much because of the mandated nature of saving but the centralised or guided control and management of funds by the state.
It must be clarified that this section covers only CPF schemes. Others are implemented through CPF for political and administrative expediency. Medisave top-ups for the aged are politically self-serving but they are charged to the Ministry of Health (MOH). Similarly, MOH has proposed a severe disability insurance scheme for both Singaporeans and permanent residents in conjunction with the National Trades Union Congress (NTUC). MOH will give a one-off subsidy for premiums as budgetary surplus permits. In the same vein, the $40,000 grant for bona fide first-time buyers of Housing and Development Board (HDB) flats to ameliorate rising property prices is strictly, not a CPF scheme; the misnomer is it as a CPF housing grant. With its data base, administrative machinery and expertise built up over the years, CPF is a logical and natural repository and agency to undertake and implement schemes including those involving old age and retirement. CPF is mindful of both real monetary and intangible political costs of being tied down by so many external agency schemes. It charges for agency services and is careful with freeridership except when politically commandeered. While various ministries and agencies work cooperatively to fulfil the national agenda as a whole, greater specialisation and professionalism by CPF is important to create the right image for it to be the ultimate national agency providing financial security in old age.

4 Differences and advantages over traditional welfare state

A quick comparison with other social security systems has two objectives. One notes the differences as CPF’s strength and advantages and the other sees these differences as possible refinements to the CPF model with new challenges to be noted in Section 5.

Anglo-Saxon systems

There are generally three routes for social security systems (Epsing-Andersen, 1990). First is the neoliberal Scandinavian route. It emphasised income maintenance in the 1960s and labour market policies, social service expansion and gender equalisation in the 1970s and 1980s. A stronger accent in the 1990s was on "workfare", priority for young and adult who traditionally needed only marginal welfare state intervention. Retraining and lifelong learning under the social investment approach became more urgent with high youth unemployment.

Second, the US, Canada, the UK, New Zealand and Australia are still routed in neoliberal camp though they are far from being uniform. New Zealand and Australia have curtailed protectionism, social wage is legislated as a de facto minimum with greater selectivity, gradual erosion of benefits and/or coverage and workfare emphasis. The US typifies a "failure-to-adjust" approach with minimum wage still existing. But unemployment benefits and value of social assistance have dropped except for pensions. Though the American market-oriented system assumes a market supplement public safety net under negotiated occupational plans, private coverage in health and pensions have declined in the 1980s. Employers have cut labour costs. As conventional occupational plans declined, more individualised employee financed and tax advantaged 401(k) programmes have appeared.

Third is the route in the European Union (EU) faced with jobless growth and generous welfare state and social insurance entitlements. As a derived consequence, it explains high labour cost problem, employment inflexibilities and catastrophic youth unemployment. Productivity gains from labour reduction were outweighed by associated costs, augmented by problems of financing of social insurance with mass retirement and mass unemployment.

Invariably, countries in the Organisation for Economic Cooperation and Development (OECD) suffered from public sector deficits and rising ratios of debt to gross domestic product.
(GDP) since the 1970s (OECD, 1998). Assessing the fiscal impact of ageing and social security burden is not straightforward as no two countries have exactly identical pension systems. But the deterioration in EU public finance and total OECD is quite clear, requiring major reform in their public pension systems.

Both falling retirement age in the pay-as-you-go (PAYG) system and private occupational pension schemes which typically specify a retirement age, discourage work at older ages. Reforms in OECD countries revolve around reductions in generosity of pension payment, increased advance funding and working longer with greater flexibility in work-retirement transition. Diversity in retirement provision has its virtues in reducing risk by diversifying across producers. High public pension is not critical for the well-being of older persons in general, more only for low income people. A shift toward advance-funding and with it a shift to defined-contribution arrangements results in a stronger linkage between what an individual contributes and receives. The future retirement system is a flexible mixture of PAYG, advance-funding, defined-benefit and defined-contribution, public and private, mandatory and voluntary, saving and earnings. The particular combinations will reflect country circumstances (OECD, 1998, p 62).

Where pension funds are relatively important, financial markets are deep and liquid and unsurprisingly, stock market capitalisation is a high percentage of GDP. The growth of advance-funding will increase the supply of risk capital and productivity improvements as well as contribute to the development of an "equity culture". More sophisticated financial products emerge with an increase in demand for risk-transfer techniques. This includes both securitisation which enables investors to transfer credit and markets risk and derivatives whereby market or price risk is reallocated among participants. Singapore has much to learn from these OECD experiences.

East Asia

East Asia is paradoxically globally unique and also has a hybrid of existing welfare states. Some East Asian social security systems share the continental European emphasis on familialism and aversion to public social services. Their embryonic social insurance follows European occupational segmented plans, favours privileged groups such as civil service, teachers and military. But they are far from being comprehensive or aims to furnish income maintenance. By default more than design, a vacuum of social security spurred the rise of company sponsored occupational welfare as in Japan. Still, Confucian familialism or communitarianism as a compensatory strategy to parallel Christian democratic social policy is unlikely to be effective or sustainable for the same reasons that some state intervention is deemed desirable.

Paradoxically, while Asian saving is very high, underdevelopment of financial markets and institutions preclude the desired economic efficiency which could produce social welfare more credibly. As late, industrialisers, Asian developing economies are caught in a rough taxonomy (Table 6) of balancing international competitiveness (labour cost) and social security and welfare protection as the main drivers (Table 6). The former is guided by market principles, so the voluntary pillar is relevant. The latter is guided by state and societal preferences, so the compulsory pillar (PAYG or provident fund) and state social assistance (welfare provider-of-last-resort financed from general revenue), are relevant.

<table>
<thead>
<tr>
<th>Social security and</th>
<th>International competitiveness</th>
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<tbody>
<tr>
<td>social protection</td>
<td>competitiveness</td>
</tr>
</tbody>
</table>

Table 6 International competitiveness versus social protection
Singapore needs to improve on social security and welfare protection. While China may have hit right formulation, it faces tremendous problems and difficulties in implementation (The Economist, 24 October 1998). Hong Kong being more market oriented may stand a better chance than China. Social security and welfare protection may he high on the Korean agenda but it needs to worry about labour costs, that is, a bit of the reverse in Singapore. The rest of the Association of Southeast Asian Nations (ASEAN) except Malaysia, seem less cognisant, aware or pressed one way or the other with either international competitiveness or social protection. Indonesia is the worst case, languishing on all fronts.

Comparative standing

Despite its seemingly exemplary model, Singapore was ranked 117 in the fourth tier in a comparative study of 172 social security systems (Table 7). The global ranking threw up three surprises. The first surprise is poor performers included the US in the third tier, reflecting its disinclination for Western European style, preferring to leave to employers and individuals. Hong Kong and Singapore were also surprises; Hong Kong in the third tier clinging to a residualist social assistance model and Singapore in the fourth because it designed financial arrangements seeking to achieve socio-economic goals far removed from social security. A second surprise is the Netherlands not in the first tier as its chosen financial arrangements have design flaws outweighing design features in expenditure programmes. The third surprise is good performers comprise four post socialist countries in the first tier though may be unable to deliver.

Table 7 Social security design scores, 1995

<table>
<thead>
<tr>
<th>Social security system constituency score (see legend below)</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
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1=old age, 2=disability, 3=survivors, 4=sickness, 5=maternity, 6=employment related, temporary injury, 7=employment related, permanent injury, 8= employment related, survivors, 9=
unemployment, 10=family benefits, 11=child benefits, 12=healthcare benefits, 13=financial arrangements, 14=administrative arrangements, 15=total score

Australia tops the first tier (19 countries) (its disability, unemployment, family support are best in world, sickness, old age, health care, survivors, among the world best), followed by Sweden, (largest, most expensive, possibly most egalitarian welfare state). The rest are France, Denmark, New Zealand, Russia, Finland, Austria, Spain, Germany, Belarus, Belgium, Ukraine, Luxembourg, Portugal, Israel, Norway, Switzerland and Armenia. The second tier (38 countries) has most of remaining Western and Eastern Europe, the better ones in Latin America, Japan and Canada. But all are beset with transitional financial crises and need to seriously rethink ability to deliver statutory obligations. The third tier (49 countries) include the poorest in Western and Eastern Europe, Latin America, Africa and Middle East, the US, Hong Kong, China and the Philippines. The fourth tier (66 countries) has all of Pacific Islands, over half of Asia and Middle East, half of Africa and one third Latin America. Unsurprisingly, 31 countries in tier four are low income. The incongruity in high income Kuwait and Singapore is because their financial arrangements sought objectives other than traditional ones related to social security.

There is a worldwide reform movement ranging from traditional welfare states in retrenchment and retreat to developing economies trying to mount more comprehensive social security nets. Industrialisation, rural migration, urbanisation and modernisation have pulled down Asian family-based, communitarian approaches to social security and welfare provision. Equally, the challenges of globalisation, ICT and KBE descend upon all in varying degrees of severity and new risks and values come into the reform equation.

Learning from US and Hong Kong

To strengthen Singapore’s first and third pillars, the American system and Hong Kong’s Mandatory Provident Fund (MPF) may be germane.

The US social security system seems most complete with all three pillars. It is market-based, laissez-faire and eclectic compared to the more ideological philosophies in the Scandinavian and EU systems. The US had been struggling since the early 1990s to finetune its PAYG system in the light of its ageing demography, chronic fiscal deficits and competitive pressures from the East Asian economies, not least, Japan. The American economy is more open and exposed than the EU in this regard which forced it to take an equally market-based solution to its social security problems. Firing, layoffs or retrenchments are not as shunned as in the EU or Japan, the latter two for different reasons.

The financial sector in the US is about the most developed and its people appear savvy and partial to equity culture. In a bold move, to allow social security funds to be invested in the stock market which has proven long term returns, there is an unsung, indirect benefit of exposing Americans to global trends and developments (Asian Wall Street Journal, 23 August 2000, p 6). Even with the fiscal deficit finally balanced by 1999 without counting social security surplus which the government has no mechanism to “save”, the overall US public debt remains high. The US national saving rate has fallen from 12% of GDP in 1965 to 5% in 1995. In 1998, personal saving rate was 3.9% of disposable income, approaching the lows of the Great Depression. While more Americans may be saving with some 63% saving for retirement, adequacy is an issue. Growing older, promised too much, saving too little, are all the unsustainable trends observed in the US.
Ageing demography and solvency problems favour partial advance funding for social security and any sacrifices to bring the system into balance should be widely shared and not borne entirely by current and future workers and their employers (Blahous, 2000). The key elements of the 21st century retirement plan include features like directing more of both the payroll tax and voluntary saving into individual security accounts (ISAs), gradually raising the eligibility age for full retirement benefits and establishing a universal salary reduction-qualified retirement plan for all employers (Belt, ed, 1999).

American 401(k) plans are particularly relevant to Singapore’s SRS. These are defined contribution plans, the most popular of Inland Revenue Service (IRS) sponsored retirement saving plans including profit sharing plans and money purchase plans. Benefits upon retirement are left up to effect of investment performance on contributions. Participating employees decide on the amount to be withheld from pay for 401(k) contribution. It is different from regular pensions as control is exercised by individuals, funded by their own money and they decide how much to save and how to invest it. It is also different from profit-sharing at the practical level as eligible employees choose to participate by making their own contributions with employers choosing to or may not match them. If employers match employees' contributions, they have to do so regardless of company having a good or bad year. Some 84% of companies do match employees' contributions (Schurenberg, 1996, p 7). The replacement ratio varies but accountants put the correct figure as 71% and upward to avoid a decline in standard of living.

401(k) plans constitute a three-way bargain involving the federal government, employer and worker to make retirement affordable. The cast of characters include first, the plan's sponsor being employer who takes responsibility to set rules for participation, chooses a plan from menu of options and optional features like hardship withdrawal, loans or matching contributions. Second, fiduciaries are people or companies with the decision making power over any aspect of the plan. They act on behalf of the plan in an informed and prudential way and are liable for any losses from their missteps. As another safeguard, the assets of every tax-deferred retirement plan must be held in trust to be administered solely for the benefit of the participating employees. The trust is legally and financially separate from the company. Third is a trustee responsible for collecting the plan's money, investing and then paying it out to retirees. The trustee does not decide which stocks and bonds to invest in. Day-to-day investment duties are delegated to the money-management firms as the fourth actor. Finally, financial services firms take care of complying with regulations, filing paperwork with the government or in record keeping or administration.

In short, plan vendors supply 401(k) plans, employers sponsor them, employee 401(k) plans are pre-tax, employer 401(k) contributions add to employee accounts. Qualified investments for 401(k) plans include stocks, bonds, money market mutual funds. 401(k) saving is tax-deferred 401k, contributions by all returns tax exempt which means compulsory growth potential. Hardship withdrawals and 401k loans are possible, depending on the company’s retirement plans. There are, however, possible with pros and cons (Butler, 1999 and 2000).

In a typical plan, investment funds rather than direct investment in stocks or bonds exist as investment options. Employees are credited with shares or units which represent their proportionate ownership of the portfolio. Virtually every 401(k) includes at least one "capital preservation" option, an investment which is low in principal risk. Two most widely used are money-market funds (almost zero principal risk) and guaranteed investment contracts (higher yields). 401(k) plans are popular with disillusion over conventional pension plans and social security for individuals with high marginal tax brackets (Butler, 1995). A successful 401(k) plan recognises what is important to a specific workforce, discern different plan design and vendor combinations which best complement a company's compensation objectives. The general rules
for plan participants show the stock market as a proven winner, averaging 6 percentage points per year more than return on money market funds.

The main lesson from the mature US model with all three pillars is it seems to be changing in the right direction to meet up with the challenges of globalisation and competition in the most laissez-faire political economy context without sacrificing state benevolence however, circumscribed. It must be noted that the American private sector, financial sector and workforce are generally most suited for its mature and relatively successful system despite its chronic twin deficits in fiscal (cured since 1999) and trade in the current account of its balance of payments. As the largest economy in the world, drawing its dynamism from immigrants and a more egalitarian society than most, the US system may be hard for Singapore to imitate across-the-board except for the 401(k) plans.

Hong Kong may similarly offer its experiences in individualised accounts with market-based management of funds. MPF schemes do well because of Hong Kong’s famous laissez-faire environment. At the onset, the level of financial sector development, availability of players and institutions with China as a large hinterland, may be noted.

The MPF was enacted in 1995 and amended in 1998 after some anomalies were identified and rectified to ensure smooth operation. It provided the second pillar together with the Occupational Retirement Schemes Ordinance (ORSO) which regulates all voluntarily established ORSO schemes operating in or from Hong Kong since 1993. These ORSO schemes are exempted from MPF. MPF covers all employees aged 18 to 65 years unless exempted. Employers and employees contribute 5% each subject to a minimum and maximum level of monthly income of HK$4,000 and $20,000 respectively. The contributions are fully and immediately vested and portable when place of employment changes. While employers pick the approved trustees supported by custodians and investment managers, employees pick the products in selecting investment of their accrued benefits. Self employed are personally responsible as for remitting and monitoring their contributions and accounts.

There are three types of MPF schemes, the master trust schemes, employer-sponsored schemes and industry schemes. A master trust scheme is open to employees of more than one employer, self-employed and persons with accrued benefits transferred from other schemes. Master trust schemes pool funds and enjoy efficiency from economies of scale and are suitable for SMEs. An employer-sponsored scheme is restricted to employees of a single employer and its associated companies only and hence address their specific needs and circumstances. These would be mainly large companies with resources to administer such schemes. An industry scheme is a specialty type of MPF scheme for industries with high intra-industry mobility so that member does not have to change scheme when employment changes to reduce transaction costs. Employers and self-employed persons can join two current industry schemes in construction and catering.

MPF schemes offer four to six different funds such as generic capital preservation fund, guaranteed fund, bond fund, stable or balanced fund and equity fund with varying investment risks. Permissible investments of MPF include equities in recognised stock exchanges, investment grade bonds, deposits with eligible banks, approved unit trusts/insurance policies, limited exposure to listed warrants, financial futures and options for hedging, currency forward for hedging and limited investment in other securities. There is a 30% Hong Kong dollar exposure in line with industry experience which can be met by currency hedging, no government investment guarantee and a guaranteed fund can be established on a voluntary basis with a capital preservation fund as proxy. Emphasis is on regulation by MPF Authority on investment management, insurance policies, intermediaries.
The main lesson is, like Singapore, but less strict and more generous by degree, Hong Kong leans more toward individual-financed and market-based means to ensure social security and welfare protection. Its first pillar may be stronger than that in Singapore and it has fiscal reserves like Singapore to support a more social-oriented protection system. Both Hong Kong and Singapore governments are efficient and operate low-regulation environments. Hong Kong is concerned that its small but on-running fiscal deficits in the recent years are not cyclical and can be structural deficits. Its private sector believing that private market allocation of resources is still superior to state, is more strident in urging that budget surpluses and reserves to be run down as (International Herald Tribune, 8 March 2001, pp 1 and 10. Both Singapore Inc and the political economy in Singapore are more prevalent and complex such that while the MPF appears to be the newest and most innovative privatised forms of social security, Singapore may only learn selectively from Hong Kong.

5 Current challenges

What worked in the past

Indubitably, the CPF model has been successful in its schemes. It is timely to review and take stock of some old assumptions of the CPF model to see how new challenges pose new policy questions and issues.

The CPF has always been a handmaiden of socio-political policies of the government, seeking the common good in welfare terms and supporting the goals of a developmental state. The abiding philosophy of ensuring full employment with a buoyant economy rather than social insurance and welfare assistance as an alternative has served well in the old economy. Given global market forces, full employment is, however, harder to guarantee. Employability becomes a problem especially with an ageing labour force faced with new technology, skill sets and mental modes of mastery of flows of knowledge and information rather than stocks of capital, skills and experience. Intellectual capital distinguished as creativity and innovation becomes more relevant than technical and hard skills. Jobless growth, end of work, labour market flexibility and deregulation, contingent and just-in-time (JIT) workforce and possibly, an impairment to tripartism and consensual wage negotiations are worrisome features.

There is a limit to which macroeconomic stabilisation through traditional Keynesian, fiscal, monetary, wage and other policies can effectively induce a restitution of economic resilience, especially if the downturn is structural or exogenous. Tying the CPF to the fiscal process and developmental state has a similar delimiting political economy reasoning with a growing political culture. For all that the various CPF schemes have achieved in housing a healthy, educated and wealth nation, there are some contentious side effects. There may be over saving with over 50% in gross domestic saving (GDS), over consumption of housing with its attendant problems of allocative inefficiency and undesirable speculation in real estate and distortions of the heavy hand of the government, however paternal and benign.

Postwar baby boomers born between 1946 and 1964 and retiring CPF members feel insecure in terms of old age security and protection. The younger, more cosmopolitan and mobile generation may feel as insecure, smothered in the paternal political economy. Whereas market competition and principles are liberally adopted in the KBE, social and political values cannot be marketised as easily. This incongruity in public policy making is not easy to resolve with growing inequity, digital divide and the marginalised and vulnerable needing more social assistance. The CPF faces a similar predicament in upholding social security and welfare
principles. It has to choose between more market-based rates of return to serve members or be hamstrung by non-economic and political economy considerations to serve the state.

The greatest threat perceived appears to be insecurity and unpredictable risks as globalisation, ICT and new economy intermingle to set a potent backlash. As a small, resource-lacking city-state amidst a region of potential socio-political turbulence, foreign economic policy becomes imperative beyond conventional attributes of international competitiveness, efficiency and productivity. The residualist approach to social safety net and welfare protection may have to change to a more proactive stance. State welfare and social assistance, not necessarily in monetary terms but in skills training and other forms of helping workers adjust competitively in the globalised new economy, may have to increase. Singapore is already doing this with its largesse accumulated of public sector surpluses though there is a fine art in just throwing money at the problems and growing the right culture with monetary incentives. For the older groups, the job and training solution may not be as simple, necessitating first-pillar, higher social expenditure.

Many CPF features make it an unique national scheme suited to the political economy of Singapore, atypical of conventional social security schemes. One is the distinctive link to the fiscal process where mandated CPF investment in government stocks was a cheap source of funds. With fiscal surpluses and no more deficit financing necessary since the 1980s, there is still the issue of implicit taxation as long as the government pays a guaranteed 2.5% interest rate, comingles CPF funds with the rest of public sector surpluses for investments abroad by GIC. In the earlier years, this implicit taxation and deficit financing were warranted with heavy demand on infrastructure including public housing. Low cost housing kept overall business costs and inflation low, fulfilled the socio-political objective of home ownership and made stakeholders out of a migrant stock. This implicit “fiscal” role of CPF has been never denied as long as a paternalistic honest government “interfered” benevolently and created a nation and economy.

Over the years, expansion of home ownership using CPF saving into other investment in gold and approved equities is premised on both stakeholder and asset enhancement. Members also groused over lack of investment choice, fairer rate of return and hedge against inflation. As a fully funded defined contribution scheme, benefit upon retirement is primarily dependent on rate of return and members are increasingly unhappy with saving locked up with CPF. The disquiet about the gap in rates of return and more self determination of old age security is also built up around the adequacy issue with rising life expectancy and cost of living. The implicit assumptions of the economic and social states which guided CPF policy and philosophy, created the trust among members since the 1960s may no longer hold in the new KBE together with immutable globalisation.

In the context of these evolving trends and development, new challenges focused on the objectives and effects of the current policy regime on rates of return affecting old age security and income maintenance are identified as follows.

Basic and added objectives in investment of social security funds

For provident funds or defined contribution schemes where accumulating funds not required for current benefit payments, the standard investment policy objectives as for any fiduciary institutions are safety, yield and liquidity. Yield refers to the overall rate of return from capital and income which must be at least equal to that assumed by the actuary in the valuation of the scheme. An additional objective may be economic and social utility justified as national infrastructure improves economic growth and standard of living of the population including fund members. This constitutes a prerequisite condition for social security schemes to meet their
promises and beneficiaries’ expectations. Other subsidiary objectives include increasing investment sophistication, domestic capital market development and globalisation of capital markets. These dictate diversification to avoid risk, matching assets and liabilities for cash flow and liquidity, allocating investment expenses so that net rates of return accurately reflect investment income from each medium. All these concerns are relevant and upheld in CPF.

These investment policy objectives do conflict and have to be reconciled in accordance to national circumstances. Generally, government and government guaranteed securities form the bulk of social security investments and for the advantage of security of capital, their rate of return is normally lower than in alternative investment instruments (McGillivary, 1998). Singapore’s CPF is thus not as exceptional as made out to be.

Governance

To ensure accountability and transparency as in good governance the design and implementation of an investment strategy should be demarcated. Governance as in overall responsibility for developing the long term asset mix, providing guidelines for investment strategy and reviewing fund performance and the actual implementation of the investment strategy and risk management should be separated. An oversight committee should comprise representative from government, labour and management as well as scope for individuals like academics and researchers with expertise either in asset management or pension finance. Members will have varying degrees of financial sophistication but the responsibility of an oversight committee is to ensure that the long term asset mix is selected in manner which minimises the funding shortfall or achieves acceptable replacement rates. The CPF Board is advised by a separate investment committee which together with the management and an investment fund consulting company, have provided reasonable good governance.

Assessing investment performance

It is inappropriate to assess investment performance of a social security scheme solely on the basis of the annual net rate of return on its invested assets. This may be the norm for private financial institutions whose clients shift their investments according to the relative performance of the institutions. This short term perspective results in competition among private institutions to maximise their annual net rate of return. It encourages trading with attendant transaction costs, leads corporations to seek favour by declaring high dividends and retaining lesser proportions of profits for long term development of their enterprises. It also contributes to market volatility as herd behaviour tends to apply and can inhibit raising of long term capital whose returns are deferred even if they may be acceptable on a discounted cash flow basis. Social security schemes are for the long term and can be reliable sources of long term capital as seen in Singapore. They can complement intermediation by private financial institutions but are obliged to generate acceptable competitive long term rates of return. But they are not in competition with private financial institutions and their investment performance should not be measured using the standard applied to these institutions.

Other management concerns

Other management issues include disclosure and public information as contributors to social security become more sophisticated. They would expect the same level of disclosure and information of social security schemes and rightly or not, tend to compare reports of private
financial institutions without fully realising they are not comparing like with like in terms of short versus long term investments. Singapore Inc is just sufficiently transparent but the comingling of funds and nonaccountability by individual fund, is a big opacity.

As capital markets become more developed with possible diversification of investment to external markets, contributors should be able to select from a number of well regulated, decentralised, competing private schemes. Economies of scale of a centralised public scheme would be lost and significant marketing costs to acquire and retain contributors must be incurred. Enforcement of compliance with contribution regulations is an unfamiliar function for private financial institutions and is complicated when contributors can change from one scheme to another, assuming they have the information and acumen to make informed choices among alternatives. The compromise or alternative is to have a centralised public scheme allocate funds to competing private investment intermediaries whose performance would be monitored and assessed.

Publicly mandated CPF saving scheme with part public, part private management of funds subject to regulatory specifications that the CPFIS represents seems to straddle these concerns with the ultimate choice left largely to CPF members. Mandatory saving schemes is unavoidable and the issue is more between public or private saving schemes once statutory social security schemes are accepted. The expectation that statutory schemes privately managed would be independent and free of government interference is illusory since governments will find the means to intervene in any adverse financial situation and in fact, expected to do so. Interference may become more difficult with multiple private institutions with greater resistance but it is by no means excluded. The fundamental principle is always an upright and honest government which intervenes for the collective good defined with some measure of paternalism and people's choice and acceptance.

Coping with inflationary impact

Neither defined contribution nor defined benefit schemes is immune from the effects of inflation. In defined benefit schemes, the inflation risk is borne collectively by contributors and beneficiaries with the taxing ability of the government as the last resort. Individuals bear the inflation risk in defined contribution schemes like the CPF, both as contributors and beneficiaries. The government is not expected to intervene except for the guaranteed minimum 2.5% interest. With low inflation managed by other macroeconomic and exchange rate policies, indexation as the best protection against inflation is not an issue.

Comparative investment performance

There is no clearly specified benchmark or investment strategy especially for long term social security funds. There is no dearth of research which has shown that the right investment policy contributes over 80-90% of total investment return. Yet, most funds spend less than 10% of time and effort in determining the benchmark. Two critical objectives on the funding policy are to maintain an appropriate funded ratio, that is, the ratio of assets to liabilities and maintain a conservative funding policy, that is, having a stable and preferably declining contribution rate. The funding ratio is affected by changes in liabilities either from changes in demography or in wage or price inflation and asset performance. The risk of being severely underfunded because of either a poor contribution policy or asset performance is termed an asset-liability risk. Setting long term asset allocation involves articulating objectives, understanding the nature of benefits or replacement rates and identifying asset classes in which investment can be made to minimise the
risk of a shortfall between assets and liabilities. Fully funded CPF averts these issues but it should be beholden to finding the best benchmark and investment strategy and ensuring adequacy members have to follow CPF policies rigorously.

It is very difficult to have a clear sense of what true market based rates of return on social security funds should be. At best, policy geared to prevent an arbitrary investment of assets requires an oversight committee to have target rates of return for each type of asset. Even in developed systems, there may be objections to invest pension funds in equity markets or restrictions on investing abroad. Unless assets have identical characteristics as liabilities, pension funds are exposed to extreme asset-liability risk when trying to manage the risk of volatile liabilities. If future cash flows are uncertain as when bonds including government bonds or fixed income securities are purchased because of inflation, a more diversified pool of assets may have properties to meet future liabilities. These are still long term issues for CPF and the evolving mix from CPFIS has to be monitored.

The general principle that private saving is preferable to public is based on the notion that markets are more efficient in resource allocation, conveys a greater sense of individual ownership and scrutiny of use of funds and greater operational efficiency through lower administrative costs. Government mandate of saving need not necessarily imply government management. On grounds of economic efficiency and returns, private management generates significantly better returns (Iglesias and Palacios, 2000). Still, there are usually many restrictions on investment options (Srinivas, Whitehouse, and Yermo, 1999) which may be understandable as the government cannot abdicate its role as trustee to protect the people as well as be a manager of pension assets and for economic and social utility. Politics inevitably enter which may hamper the government's ability to invest effectively. Government interference is more usefully viewed as a continuum rather than a simple dichotomy between public and private management. The CPF has shifted from a direct role of government as manager of pension funds to imposing stricter government regulation of the private sector which facilitates individuals' investment choices and appetites. In either case, government influence on investment decisions is not necessarily diminished.

More than 50 countries have built up reserves to partially or fully cover pension liabilities and the estimated stock of pension assets including voluntary pensions is as much as 50% of world GDP (Palacios and Pallares-Miralles, 2000). Malaysia and Singapore top the list of countries with centrally managed defined contribution funds as 55.7% and 55.6% of GDP respectively. Results for Singapore and Malaysia merit highlighting with low but positive rates of return despite being among the fastest in rates of income growth in last three decades (Iglesias and Palacios, 2000). Both have prescribed yields to members based on short term interest rates while actual investment returns are believed to be much higher. This implicit taxation of returns rather than poor investment is unsurprising given the political economy of the fiscal process and development strategy pursued in both countries. From the worker's perspective, the implicit taxation results in a low replacement rate and the criticism is valid and has gained momentum for workers about to retire after contributing their entire working lives and find low balances insufficient to support preretirement living standards. While there are more top-up schemes for older persons in Singapore as for Medishield and Minimum Sum, the political dividend being paid is meagre and patronising.

Two hypotheses tested are the level of governance in a country affecting performance across countries and a general "public management effect" which itself asserts low returns (Iglesias and Palacios, 2000, pp 29-32). Singapore, Switzerland and Netherlands are ranked highest (10) on the governance index (Mauro, 1995). Combining the two effects, one tentative conclusion is that based on experience to date, publicly managed schemes are likely to perform
very badly in countries with low governance ratings, fare better in countries with good
governance such as Singapore. The CPF has moved one step further by liberalising CPFIS in one
fell swoop, de facto shifting from publicly to privately managed pension funds.

Challenges to old age income security in Singapore as in Asia Pacific include
demographic ageing, breaks in economic growth path, extending coverage to self employed,
homemakers and more institutionalised formal safety nets for needy elderly (Holzmann,
MacArthur and Sin, 1999). It does not have the agrarian and informal sectors to worry about but
more Singaporeans working abroad with regionalisation may be an issue if they opt out of CPF
however temporarily.

Debating rates of return

Indubitably, the difference in CPF interest rate paid to members and what GIC earns from
investing mandated CPF funds together with all public sector funds, is the crux of the debate on
rate of returns. Comingled CPF and Monetary Authority of Singapore (MAS) funds invested by
GIC can neither be a good investment nor management strategy as returns and performance
cannot be effectively tracked. Institutional and agency investment policy objectives are dictated
de facto by government. This political fiat is a further issue to the conventional principal-agent
problem. CPF as a retirement fund has distinct needs and goals. In whatever manner the
government has provisioned for CPF operational expenses, the nontransparent system is not just
a matter of good governance or accountability. The state holds absolute stewardship in social
security but the issue is one of serving its own political economy interests or that of CPF
members’ especially if these are no longer as congruent as in the past.

On the plus side of the current system, as GIC invests abroad, it carries CPF funds out in
a manner which would otherwise compromise the usual conventional wisdom that social security
funds should be invested at home. Some of amelioration of implicit taxation with CPFIS has
been discussed. The issue is one of holding the moral high ground to use budget surpluses
garnered by the government to pay political dividends and as an implicit redistribution
mechanism. Through the CPF, the government has periodically topped up Medisave and Special
Account for older members, gave share option top-ups (SOTUS) for members to participate in
Singtel’s privatisation in 1993. It does not hurt that votes and image for the government may be
maximised.

On the other side of the balance, the centralised system suffers from low rates of return
not so much due to poor investment as implicit taxation of returns, with as much as a 3%
differential as alluded (Asher, 1998). Mandatory investment means social security funds are held
hostage to budgetary needs and politically determined investment decisions which can also
impede development of new financial instruments. Decentralising involves opting out for part of
accumulated assets, outsourcing asset management to private sector under competitive bidding
procedures, outsourcing asset management and investment to foreign investment companies,
creation of private pension funds and allowing individuals and employers to shift assets to
private sector. Some of these features including SRS as US 401(k)-type of investment have
evolved. More innovative creations may be expected in time.

Both SRS and CPFIS constitute a move toward 401(k) plans as private management is
available to individuals. But management fees and transaction costs remain high, more so when
members can choose and migrate at will as seen also in Hong Kong’s MPF. To create and
support the provision of new instruments, market priced government bonds and price indexed
annuities need to be issued by the government and private insurance companies respectively. But
it takes time and public education across-the-board before people can make informed choices as
under a theory of rational expectations. There is always a gap between what people believe they
can do themselves when they perceive their options are closed and not they cannot exercise
choice and when they are given the choice and they cannot seem to make the right ones in
reality.

It is difficult to separate the issue of adequacy of CPF saving from that of low rate of
return and perhaps, the real issue is that while a lower rate of return is acceptable, how low that
is, is not. Aggravating the perception is that the government is "profiting" from the difference in
rates of return, between what it gets for investing funds garnered from CPF mandated to invest in
government stocks and the guaranteed 2.5% rate paid to CPF members. We need to dissect the
issue further to examine what are the benefits of a guaranteed rate of return of 2.5%. Is the issue
more with the magnitude of 2.5% considered as low, and if so, what should the correct rate?
How is the government deemed to "profit" if there is economic and social utility from the
government's management of long term capital for economic growth, even if not as equitably and
directly as desired?

The inflation issue has been moot even if the guaranteed 2.5% is nominal, not real. There
is no need for costly indexing as the effects of higher inflation would be reflected in higher
nominal interest rates in the market, like a tide raising all boats. De facto, the government
protects CPF members from inflation by a guaranteed rate and low inflation as a matter of
policy. Other intangible and indirect gains of the current system include tax exemption of CPF
contributions and subsequent gains on interest.

Conceding that 2.5% rate is low, there are two lines of argument. One is what is a more
reasonable long term bond rate which is fairer. Two is how the right rate of return should also
take into account management costs, implicit benefits of a guaranteed component and economic
and social utility of the government "profiting" from the difference in interest rates. In a word, it
is politics more than economics. The crux of rates of return boils down to the perceived
dissatisfaction with the government making gains from its intermediation and control per se is
bad. The state has gained political capital for the last three and more decades. With national
infrastructure and capital development needs more or less satisfied including public housing, the
issue at hand is should the government refocus on private capital market development? Greater
political maturity also dictates more autonomy and self determination under an appropriate
governance and internal structure for CPF take care of its members' interests as a first priority.

While home ownership is in and of itself not a bad policy to glue together an immigrant
population and generate an asset owning people, what is doubtful is the 100% target. This leaves
the housing market rigid without a viable rental component. Tying housing with the CPF may
have been brilliant. But as in all public policy, there seems an inevitable trend that a good policy
may be taken to excess both in magnitude and duration. In other words, had a more voluntary
and some freedom of choice been exercised with less government coercion and more market
play, CPF home ownership scheme could be more flexible and accommodating to changing
circumstances. Instead, the folly of reverse mortgage scheme, inflexibility of leases in
commensurate with age and needs of owners, speculative and legacy effects may have been
overplayed.

Home ownership is an inherent risk in more ways than one. First, it takes up a large
proportion of old age security fund, worse if members withdrew funds allowed to the hilt to
speculate in real estate. Second is the tenuous argument of holding real estate as a hedge against
inflation because there is the vicious circle of demand pull inflation created by the artificial
demand for housing. The speculative casino effect affects work attitudes and honest labour
income in contrast to windfall capital gains. This may outweigh and prove even more perverse
than the merit of socio-political stability with 100% home ownership. The effects are in fact
spilling across the causeway into the region. Singaporeans speculating in real estate overseas have been burnt whether or not there were extenuating circumstances from the Asian financial crisis. Three is housing is generally illiquid and in a city-state, cyclical effects are unpredictable. The 100% rigidity necessitating inevitable government intervention when cycles prove hurtful to mortgages was what happened when CPF rates were cut in 1999. The state encouraged housing in the first place, so is beholden to “rescue” home owners and "upgraders"; two wrongs (both distortions) do not make a right and a doubly distorted market was the outcome. Tied up with political economy arguments, no pure economic solution can unravel the distortion. The irony and enigma is as the economy aims to be more market based and liberalised, there is no parallel in land, labour and capital (saving) markets. The small open city-state economy needs openness and competition in the former, not in the latter.

The argument that CPFIS has liberalised to allow CPF members to be effectively handling their own investment portfolios with professionally managed products takes time. The poor 1999 returns from CPFIS have shown that. Even with professionally managed products, the assumption that the average CPF member is sufficiently knowledgeable to make informed choices, weigh long term gains over myopic ones is onerous. That there are sufficient market instruments and providers to help individual investors in investment products is another assumption.

Adequacy and replacement income

The replacement rate is the ratio of retirement income expressed as an income stream to income earned in final year of employment. It is a measure of the extent to which retirement income replaces working income. A basic principle is for individuals to retire with an adequate level of saving to maintain living standards. Adequacy of retirement income is relative to the individual or cultural norms rather than some universal measure. The replacement rate is earned in gross terms, the ratio of gross retirement income to gross income in the final year of retirement, such that the impact of income tax on both retirement income and employment income needs to be taken into account when estimating an actual replacement rate. Individual and community may have significant differences in the perception of a sufficient replacement rate. The individual views a sufficient retirement income as an amount which allows consumption of a similar pattern of goods and services in retirement to that consumed while working. The community might view a sufficient retirement income as private saving which provides an income stream equivalent to the aged pension or which provides for at least a minimum level of consumption.

As a guide, the generally recommended replacement rate of 60% assumes people have fewer costs in retirement compared to when working. But the rate also depends on family size, home ownership and lifestyle aspirations after retirement. With homeownership so widespread, even a 50% replacement rate in Singapore may not be too far fetched from the usual 60 to 70% range. But female homemakers may pose a problem. Generally, replacement rates for females follow the same pattern as for males but they are universally lower to reflect fact that women live longer. Even if the same lump sum net benefits go toward purchase of an annuity, the female expects a lower annual income stream as her average life expectancy after retirement is longer. The top-up scheme by spouses for nonworking wives has not been popular as the family social safety net remains the norm.

Social insurance and annuity
It is inescapable that some social insurance may have to be considered while an entitlement society is not the best solution. Episodal unemployment, higher risks and volatility in fixed income schemes with all the due diligence possible, would be hard to avert or avoid even for Singapore. Social insurance is not in the strict economic sense of risk spreading and pooling but risk prevention through limits on individual choice in enforcing saving, prevention of speculative investment vehicles and impeding certain individual choices. The manner and extent of such limitations on individual choice are considerable and potentially subject to finetuning.

Annuity is a funded benefit plan which carry two risks of promised interest rate or returns and life expectancy of subscribers. Insofar as providers are perceived to play a supportive social role and enhance the collective good of society, tax and other incentives can be justified just like extending the age for Medishield to 75 for "bad" risks. That the net must be sufficiently large to balance risks across group is tricky. Singapore is so small to justify either compulsion or a natural monopoly as competition among too many insurers fragment the base. Increasing rather than decreasing costs may result especially if "bad" lives are left in some markets.

Study of annuities markets in Canada, the UK, Switzerland, Australia, Israel, Chile and Singapore show they are poorly developed. Reasons include worker myopia, precautionary and bequest motives for saving not served by annuities, general distrust of insurance companies and unwillingness to turn saving over, adverse selection and crowding-out effect by social security system (Estelle Vittas, 1999). The government has encouraged annuity business but a mindset change to this means of income maintenance is a formidable challenge.

6 Conclusion and policy implications

This paper has reviewed what worked in CPF, transforming Singapore from third world to first. CPF schemes are intimately tied up with economic and socio-political aspects of growth and development. CPF is a crucial lynchpin in the developmental Singapore Inc ensemble. Through CPF schemes, the state has managed people's aspirations to fit the economic growth and political economy development model. Overall, CPF is a sui generis national scheme, unrivalled in both its innovative schemes and unbridled desired political economy goals. Tying CPF with the fiscal process through its mandated saving in government securities is intended, never mind how CPF is ranked among other social security systems based on more conventional benchmarks. Unlike elsewhere, this fiscal tie has not been abused. High fiduciary responsibility and accountability are hallmarks, even if transparency is not.

The de facto state guarantee of CPF through an explicit guaranteed minimum 2.5% interest is almost risque with an implicit taxation on members. GIC almost always earns more with cameled public sector funds. CPF members are further none the wiser with across-the-board intransparent GIC investment strategies. There is no accountability of individual fund strategy and performance. All these political economy features make any analysis or assessment of CPF hard, almost like challenging motherhood statements like government-knows-best and "in PAP we (Singaporeans) trust", both as a matter of habit and fact.

In the globalised new KBE in conjunction with ageing demographics, the crucial assumption of full employment in the CPF model may give way to episodal unemployment, unemployability, income insecurity and inequity. This has implications for the current workforce as well as the aged dependents they support. Delinking CPF from the fiscal process is argued for better rate of return and avert the use of top-ups as political dividends with cross subsidy effects. Other challenges identified include need for a greater acceptance and use of annuities and some social insurance as a last resort with growing risks, uncertainties and volatility.
The CPF as the main social security pillar has to be augmented and supplemented by the other two pillars. Despite its own reforms to cope with rising health care costs, low national saving in an ageing society, the US system, especially its 401(k) plans is worth studying. This is particularly timely as CPFIS has been liberalised which also takes off some criticisms of implicit taxation and state control of funds. Further privatisation of fund management as under Hong Kong’s MPF is worth some consideration. While both city-states boast of sophisticated liberalised financial centres, private sector response from Singapore seems to lag. It could be that Hong Kong is still more laissez-faire in spirit and reality. But CPF is ahead of MPF as the latter has yet to consider annuity schemes.

CPF appears to have taken steps to address most issues and challenges through various changes since 1999 for CPFIS, contribution rates for Medisave and Special Accounts, liberty to transfer up to $40,000 from Ordinary to Special Accounts for higher interest rates and others. The 1995 and 2000 National Survey on Senior Citizens conducted by Ministry for Community Development provide rich insights into financial planning or lack thereof to guide public sector policy makers and private sector providers of financial products and other services. The 1999 Interministerial Committee on the Ageing Population gave many across-the-board perspectives which require coordinated and collaborative efforts. Issues range from adequacy of Medisave to how CPF schemes and goals should be reprioritised and back to old age security and income maintenance is clear and definitive, not more housing, upgrading and asset enhancement to finesse old age. Preventive healthcare, healthy lifestyles and work styles, planning and taking charge early for retirement are prevailing policies round whether or not they involved CPF schemes.

With changing external drivers and diverging domestic needs and expectations, CPF’s greatest challenge is how to preserve old age security, take members’ interests as its top priority rather than serve state interests first and members only as a directed outcome. Should or could CPF delink itself, keep an arm’s length in its dealings with the fiscal process and political taskmasters? How can CPF keep state interference, however benign and paternalistic at bay and provide an unadulterated focus on members as its ultimate clients? Has centralised public sector control of CPF saving been finally severed with CPFIS changes? How much more autonomy and self destiny can CPF and members be given without destroying the political economy?

Despite these unanswered questions, one may be sanguine about CPF as a provider for old age security. The record thus far had been impeccable in contrast to systems elsewhere in the region. Neither is it conceivable that the PAP regime which innovated and patented CPF so ardously and diligently would let it fail just when postwar baby boomers are due for retirement. A generation of CPF policies and schemes are about to be tested and pay off and CPF is too big to falter, lest fail. Neither CPF nor its parent Ministry of Manpower have been acquiescent or passive about stress and strains from globalisation, ICT, KBE and within. CPF as a centre piece in the developmental state will most likely be finetuned alongside as Singapore Inc is reinvented and reengineered.
Bibliography


Income security and maintenance for old age: Singapore's Central Provident Fund

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Abstract

Singapore’s Central Provident Scheme makes it a welfare state in its own right, only difference being it is not financed by the state but by the people themselves but still guided by very paternalistic schemes. Successful as the model has been, the basic assumption behind the CPF model has been full employment. Faced with greater income insecurity, volatility and possible episodal unemployment and unemployability in the new knowledge-based economy (KBE) challenged by information communication technology (ICT) and globalisation, this basic assumption of state guaranteeing full employment has changed. Ironically, there may be greater need for state welfare, some social insurance pooling of risks and resources also with demographic ageing. With CPF being part of wage costs, Singapore has to straddle between economic competitiveness and social protection and welfare for all, especially older workers. It is in the light of these external and domestic trends that this paper looks at the reinvention of CPF together with Singapore Inc and the developmental state in which CPF plays a critical role in the way it is linked with the fiscal process. In all, revamping a national scheme like the CPF has obvious political economy issues, some more unique to Singapore than most.