Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

March 2006

Europe

Belgium

On December 16, the legislature approved a package of measures to increase the employment rate. The "Generation Pact" seeks to encourage workers to continue in the labor force longer and to discourage early retirement. Most of the law's provisions are scheduled to begin in 2008, but some will be implemented this year. The law was published on December 30, but employer and employee organizations are still negotiating many of the details. It is clear, however, that current retirees will not be affected and that the normal retirement age will not change.

Belgium's population is aging rapidly, and its workers are withdrawing from the labor force at an earlier age than are their counterparts in the rest of the European Union (EU). This is largely the result of government actions in the 1970s and 1980s that introduced unemployment benefits and other prepension arrangements to encourage workers to retire before the age of 60 to free up jobs for younger workers. According to the Organisation for Economic Co-operation and Development, the average age of Belgian men leaving the labor force is 58.6 and for women, 58.4. This compares with the average ages 61 for men and 60 for women in the European Union. Today, only 28 percent of Belgian workers aged 55 to 64 are employed, and only 27 percent of those aged 15 to 24 hold jobs.

The key provisions of the Generation Pact that affect older workers and retirees include the following:

- Between 2008 and 2012, the minimum age at which one may be eligible for prepension benefits will gradually rise from age 58 to age 60, with exceptions for workers with arduous occupations. At the same time, the number of years of employment required to qualify for a prepension benefit will increase from 25 to 35.
- Beginning April 1, employers will no longer be exempt from paying social security taxes on supplemental payments made to employees under the federal "time-credit" leave program. (This program entitles employees who satisfy minimal work requirements to a full-time career break or reduced working hours while they receive a flat-rate state allowance that is supplemented by the employer.)
- Since January 1, those who work until the normal retirement age will be eligible for lower tax rates on investment earnings from private group insurance and pension funds. A higher pension benefit (as yet undetermined) will be paid to those who continue to work between the ages of 62 and 65.
- Workers who are older than 45 and who lose their jobs will now be required to retrain and conduct an active job search for 6 months before becoming eligible for an early retirement benefit.

In a related policy, the government has taken steps to secure additional financing for its public pension system. Beginning this year, the system will receive further funding through a withholding tax of 15 percent on annual income from investment funds that hold 40 percent or more of their assets in fixed-income securities. Additional support will come from an annual tax on certain classes of life insurance premiums.

Looking ahead 25 years, the government estimates that without pension reform Belgium's support ratio of workers to pensioners, currently at 3 to 2, will be reversed to 2 to 3 and that public pension expenditures will grow from about 9 percent to 12 percent of gross domestic product.

Under Belgium's pay-as-you-go system, workers contribute 7.5 percent of earnings, employers pay 8.86 percent of payroll, and the government provides annual subsidies. The full pension replaces 60 percent of average lifetime earnings (75 percent for a married couple) up to the maximum annual earnings of €39,368 (US$40,024). Full benefits are available to men at the age of 65 who have 45 years of coverage and to women at the age of 63 with 43 years of coverage. By 2009, the retirement age for both men and women will be age 65 with 45 years of coverage.

Sources: *Social Security Programs Throughout the World: Europe, 2004*; "Time Credit and Leave Schemes in the Belgian Welfare State," TLM.net conference: Quality in Labour Market Transitions: A European Challenge, Royal Academy of Sciences, Amsterdam, November 25–26, 2004; "The Belgian Stability Programme (2006–2009)," Belgian Federal Public Service of Finance, 2005; *European Pensions & Investment News*, February 28, 2005; Organisation for Economic Co-operation and Development, May 2005; Dow Jones News Service, October 26, 2005; *Financial Times*, October 29, 2005; Dow Jones International News, November 8, 2005; Reuters, November 10, 2005; Brusselsreview.com, November 22, November 24, and December 16, 2005; "VBB on Belgian Business Law," Van Bael & Bellis, December 2005; Deloitte Touche Tohmatsu, December 27, 2005; personal communication, Brussels office of Hewitt Associates, January 2006; *European Labour Law Bulletin*, February 2006; European Commission, February 15, 2006; International Monetary Fund, March 1, 2006.

Netherlands

The Dutch parliament has postponed until July 1 the date when employees will be able to choose to participate in the new voluntary *levensloopregeling*, or life cycle savings plan. The government decided on the delay in November because of the complexity of preparing for the plan's new rules, particularly for small employers. The life cycle plan was implemented on January 1.

The new life cycle plan replaces the unfunded early retirement arrangements (*vervroegde uittredingsregelingen*, or VUTs, and prepension plans) that lost their tax advantages for persons below the age of 55 as of January 1, 2005. Over the years, large numbers of Dutch workers have prematurely left the labor force through early retirement plans. According to the government, 61 percent of those aged 55 to 65 no longer work, making the effective retirement age in Holland at about age 60—5 years below the normal retirement age. (See also the December 2004 issue of *International Update*.)

The life cycle plan provides workers with an opportunity to finance various forms of unpaid leave throughout a career—for education, sabbaticals, parental leave, and early retirement. Workers will be permitted to save as much as 12 percent of pretax annual salary, up to a cumulative balance of 210 percent of final pay earned in the previous calendar year. Employers must make a life cycle savings plan available to their employees. If an employee chooses to contribute to the savings plan, the employer will be required to pay nonparticipating employees additional salary in an amount equal to the life cycle contribution.

Workers will be able to choose the financial institution in which to invest their life cycle savings, and they will be allowed to withdraw accumulated funds during a long leave period or at early retirement with the payments taxed as income. Life cycle savings plans will be available through banks, insurers, pension fund subsidiaries, and investment companies. Industry experts estimate that the market in 2006 for these products may be approximately €2 billion (US$2.4 billion).

Sources: Hewitt Associates, December 2004; *International Group Program (IGP) Country Profile, 2005: The Netherlands*, John Hancock Financial Services, 2005; *European Pension & Investment News*, January 17, 2005; IPE.com, March 31, October 5, and November 21, 2005; Mercer Human Resource Consulting, October 24 and 28, 2005; *Global News Brief*, November 2005; *Brans Brief*, December 8, 2005; University of Twente (Enschede, Netherlands), January 25, 2006.

The Americas

El Salvador

A law enacted in December makes several changes to El Salvador's rules for individual accounts. Beginning in June, asset management companies (AFPs) will be required to lower their administrative fees to allow workers to save more for retirement. In addition, new rules in effect since January 20 encourage El Salvadorans working abroad to participate in the individual account system, and other rules place restrictions on how often a worker may transfer from one AFP to another.

Decree Law 891 lowered the maximum combined fee from 3 percent to 2.7 percent of earnings that an AFP can charge for administration and for survivors and disability insurance and shifted the cost from the worker to the employer. The breakdown of the fee will be 1.4 percent for administrative costs and 1.3 percent for survivors and disability insurance premiums. The total individual account contribution rates will remain the same for workers and employers—6.25 percent and 6.75 percent of earnings, respectively. Officials estimate that these changes could add some US$7.5 million annually to the accounts of the 1.3 million workers currently enrolled in the system.

Another provision of the new law allows El Salvadoran citizens working outside the country to set up and contribute to an individual account directly. Until now, nonresident El Salvadorans could participate in the system only by using a third party within El Salvador to handle all transactions with the AFP. Nonresident El Salvadorans must pay a monthly administrative fee of 1.5 percent of earnings; however, regulations relating to survivors and disability insurance for these workers have not yet been issued. A related provision permits foreign workers who leave El Salvador permanently to either transfer their funds to an individual account in another country or receive a lump-sum payment.

El Salvador has only two AFPs, both of which incur large marketing costs and additional costs for processing new applications and exit requests. In 2005, about 36 percent of all account holders switched AFPs. To reduce the costs to AFPs of frequent fund transfers, the new law places restrictions on how often workers may change from one AFP to another. Now workers will have to remain with an AFP for at least 1 year instead of only 6 months.

The two AFPs combined manage assets of about US$2.9 billion, or 18.8 percent of gross domestic product. The public pay-as-you-go system was closed to new entrants in 1998 when the individual account system was introduced. Since that time, the average real rate of return on assets has been 9.24 percent. Today, about 97 percent of all covered workers have individual accounts, with the remaining 3 percent enrolled in the old public system. About 75 percent of account holders are under the age of 40. (See also the July 2004 issue of *International Update*.)

Sources: "Boletín de Prensa," Superintendencia de Pensiones, noviembre de 2005; "Resumen estadístico previsional," Superintendencia de Pensiones, diciembre de 2005; *Boletín Estadístico*, diciembre de 2005; Decreto 891, Reformas a La Ley del Sistema de Ahorro para Pensiones, 21 de diciembre de 2005; The Fund Pro Latin America, January 22, 2006; "Comunica a todos los empleadores y pagadores del sector privado, público y municipal," Superintendencia de Pensiones, 25 de enero de 2006.

Asia & the Pacific

Taiwan

New pension rules that reduce benefits for many current and future civil service retirees became effective February 16. The new rules will affect more than 80,000 retired government workers and 400,000 retired military personnel but will not apply to high-ranking government officials. Monthly pensions for civil servants with at least 35 years of service will now be capped at 95 percent of final salary. Benefits to workers retiring with at least 25 years of service will be capped at 85 percent of final salary, with an additional 1 percent for each year of service beyond 25 years.

The new rules are intended to narrow the gap between retirement benefits for the civil service and the private sector. (See also the April 2005 issue of *International Update*.) Before the rule change, many civil servants received pension benefits larger than their preretirement salaries. The benefit reduction was originally announced in November 2005 by the Examination Yuan, the presidentially appointed executive body that oversees and administers the country's civil service workforce.

Sources: *China Post*, November 11, 2005; Central News Agency—Taiwan, November 13, 2005; *Taipei Times*, November 17, 2005; Asia Pulse, February 17, 2006.

Turkmenistan

On January 25, President Niyazov signed a law to suspend pension payments immediately to more than 100,000 pensioners and reduce payments to another 200,000 retirees by 20 percent. The number of retirees receiving a pension has dropped from 336,000 last year to 229,000 now. The new law also eliminated public payments for maternity and sick leave, which employers are now required to provide.

According to government officials, the action was taken because a review of the pension system found statistical errors in the number of eligible pensioners, with particular discrepancies among agricultural workers. The cuts in pensions will have a decided impact on Turkmenistan's population of 5 million, of which 58 percent currently live below the poverty line. In addition, the unemployment rate is reported to be as high as 60 percent, despite the rich resources of natural gas and oil in the country.

Turkmenistan's earnings-related public pension system pays retirement benefits to men aged 62 and older who have worked 25 years and to women aged 57 and older who have worked 20 years, with reduced eligibility requirements for women with three or more children or with disabled children. Turkmenistan has a life expectancy at birth of 58 years for men and 65 years for women.

Sources: *Social Security Programs Throughout the World: Asia and the Pacific, 2004*; *The World Factbook, 2005*; *Guardian* (London), February 4, 2006; Reuters AlertNet, February 6, 2006; Radio Free Europe/Radio Liberty, February 7, 2006.

Reports and Studies

The European Commission (EC) has submitted a report to the European Union (EU) Finance Ministers urging them to intensify reform efforts in the face of rapidly aging populations. The February 13 report, produced jointly with the Economic Policy Committee, provides detailed projections to 2050 on the costs of pensions, health care, long-term care, education, and unemployment in each of the 25 EU member states. The report predicts that demographic changes resulting from low fertility rates and rising life expectancy will be immense—causing the working-age population (ages 15 to 64) to fall by 16 percent (48 million people) and the population aged 65 and over to grow by 77 percent (58 million people.) The ratio of working-age adults to retirees will be cut in half—from 4 to 1 to 2 to 1.

The report predicts that without reform between now and 2030 potential economic growth rates will be severely curtailed. The average growth in gross domestic product (GDP) is projected to decline from 2.4 percent in the period 2004 to 2010 to 1.9 percent from 2011 to 2030 and drop further to 1.2 percent between 2031 and 2050.

The report concludes that by 2050 public spending on pensions and health care as a whole will increase by about 4 percent of GDP. Over that same period, the pressure on public pension spending will be stronger in some countries than in others and will range from modest increases of 0.4 percent and 0.6 percent of GDP for Italy and Sweden, respectively, to substantial increases of 9.7 percent for Portugal and 10.5 percent for Cyprus.

Although most EU members will experience rising long-term public pension expenditures, countries such as Poland and Austria, having reformed their public pension systems, will see the cost of their pension systems decline over time. In 1999, Poland transitioned from a defined benefit, pay-as-you-go system to one of notional defined contribution accounts and a system of mandatory fully funded individual accounts. Austria implemented reforms in 2004 that increased the legal retirement age, linked contributions more closely with benefits, and reduced benefits for early retirement. Later this year it will change the indexation of retirement benefits to reflect increases in prices rather than increases in wages. Because of these reforms, the projected 2050 pension expenditures of Poland and Austria are expected to be less than they were in 2004 by 5.9 and 1.2 percent of GDP, respectively.

The report updates the commission's official projections of 2001 by accounting for pension reforms that have been enacted in the past 5 years. The report is able to compare projections across member countries, despite their very different systems for national pensions, health care, and education, because of the collaborative effort of member states of the Economic Policy Committee and the European Commission. The entire report is available at http://europa.eu.int/comm/economy_finance/epc/epc_sustainability_ageing_en.htm.

Sources: *The Impact of Ageing on Public Expenditure: Projections for the EU25 Member States on Pensions, Health Care, Long-term Care, Education, and Unemployment Transfers (2004–2050)*, Economic Policy Committee and the European Commission, European Union, February 15, 2006.

International Update is a monthly publication of the Social Security Administration's Office of Policy.

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SSA Publication No. 13-11712