Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

January 2004

Europe

Czech Republic

In early January, the Czech government unveiled its proposal to reform the pay-as-you-go portion of its social security system along the lines of the Swedish model of notional defined contributions (NDC). The current Czech system consists of a defined benefit (DB) program supplemented by voluntary individual accounts.

Under an NDC system, each worker has a hypothetical account made up of all contributions during his or her working life and, in some cases, credit for unpaid activity such as caregiving. A rate of return attributed to an account is generally tied to an economic factor such as changes in wages or economic growth. A pension is then calculated by dividing the account balance by an annuity factor that includes the average life expectancy at the time of retirement, a rate of return, and the rate for indexing future pensions. The effect of NDC programs is to create incentives for later retirement. Details on the proposed Czech NDC system have not been released.

Part of the reform already passed by parliament gradually raises the retirement age to 63 by 2013. To encourage participation in voluntary individual accounts, which were created in 1994, the government provides a matching contribution and tax incentives for both employees and employers. Today, about 25 percent of the country's workers have voluntary individual accounts. Under the defined benefit program, employers contribute 19.5 percent of payroll, while workers pay 6.5 percent.

Pension reform is crucial because by 2020 the Czech population is projected to be one of the oldest in Europe—with 18 percent of the population over 65, up from 15 percent today—and the current pay-as-you-go DB system is already running a deficit. Today the national deficit is 6 percent of gross domestic product (GDP), with pension deficits accounting for about one-sixth of this total. Deficit reduction is a very high government priority, as it is tied to the country's future membership in the European Union later in 2004. In order to adopt the Euro as its currency, a country must have a budget deficit of no more than 3 percent of GDP. The fiscal reforms that included raising the retirement age are expected to reduce the deficit to 4 percent of GDP by 2006. To date, the government has not issued any estimates of how much an NDC system would further reduce the deficit.

Sources: *The Business*, October 12, 2003; *Interfax Czech Republic Business News*, December 5 and 12, 2003; *CTK Business News*, December 9, 2003; EIU Newswire October 28, 2003; *Pension Reform in Central and Eastern Europe*, 2002; Cichon, "Notional Defined-Contribution Schemes: Old Wine in New Bottles?" 1999; Social Security Administration, *Social Security Programs Throughout the World: Europe, 2002.*

France

French workers will have two new options for retirement savings beginning January 1, 2004. With their focus on retirement, these new programs are expected to help solidify the foundation for a voluntary funded pension pillar.

The new individual retirement savings plan (PEIR) is an insurance contract that enables people to accumulate assets for the purchase of an annuity. Workers can contribute as much as 10 percent of annual income, up to €24,000 (US$30,106), in a PEIR on a tax-favored basis. The annuity will be subject to personal income tax.

The PEIR replaces another tax-favored savings product, introduced in 1990, that allowed an individual to contribute up to €92,000 (US$115,405) over a 10-year period. The contributions and interest earned in the old plan were exempt from income tax for funds held in the accounts at least 8 years.

Meanwhile, a new voluntary employee pension savings plan, PPESVR, will replace a plan established in 2001 to encourage short- to medium-term savings. In contrast to the 10-year time limit for funds invested under the older plan, the PPESVR extends the contribution period up to retirement, eliminating the need for periodic rollovers. Both employee and optional employer contributions receive favorable tax treatment. Benefits from the new plan will be taken as an annuity, although lump-sum payments are also permitted at retirement.

Workers may also have early access to funds in their accounts under specific circumstances.

Sources: http://www.ipe.com, January 6, 2003; *european industrial relations observatory (eiro) on-line* (http://www.eiro.eurofound.ie), September 2003; Watson Wyatt, October 2003; AFX International Focus, September 16, 2003; http://www.retraites.gouv.fr, November 26, 2003; *Societe Generale–Votre Banque en Ligne*, no date; and *Épargne magazine*, December 2003.

Italy

Negotiations between Prime Minister Berlusconi's coalition government and major unions on ways to change the pension system remain deadlocked. The reform proposals were approved by the cabinet and sent to parliament in September 2003. Following a nationwide general strike on October 24 and union-led demonstrations throughout Rome in early December to protest the proposed reform, the two sides returned to the negotiating table. The government has proposed extending the dialogue until the end of January, when the Senate is scheduled to consider the reform bill. The proposed reforms are expected to save approximately 0.7 percent of GDP annually from 2012 to 2018 and about 0.6 percent of GDP each year between 2018 and 2030.

According to government projections, pensions account for approximately 14 percent of GDP—one of the highest ratios among industrialized nations—and could reach 16 percent in 2030–2035 without reform.

Sources: Dow Jones International News, January 13, 2004; *Financial Times*, January 12 and 13, 2004; ANSA–English Media Service, January 12, 2004.

United Kingdom

The Government Actuary's Department has released new population projections for the UK using revised assumptions of future life expectancy. The new figures "assume lower mortality rates, particularly at older ages."

The actuaries now estimate that by 2041, a man aged 65 should expect to live an additional 20.9 years, a jump of nearly 10.6 percent from the previous forecast made in 2001; for men over age 80, life expectancy is now expected to be an additional 10.2 years, an increase of 13.3 percent. In addition, life expectancy at birth in 2027 is projected to be around 1.5 years greater than that assumed in previous projections.

The new actuarial calculations project a total population of 64.8 million in 2031, an increase of about 1.9 percent over the previous estimate. The implications of a larger population living longer than previously assumed will adversely affect future pension financing. To cope with this challenge, pension and industry analysts are suggesting a revision of labor practices, such as increasing the retirement age or promoting phased retirement.

Sources: "New United Kingdom Population Projections," press release of the Government Actuary's Department, December 18, 2003; "Summary of assumptions," Government Actuary's Department, December 18, 2003; *Financial Times*, January 7, 2004.

Asia and the Pacific

Abu Dhabi

The government of Abu Dhabi has extended its public-sector pension fund to the private sector. The Abu Dhabi Retirement Pension and Benefits Fund, established by law in 2000, manages retirement benefits for the government and semigovernment sectors in the emirate of Abu Dhabi. The fund has recently decided to extend pension coverage to United Arab Emirate (UAE) nationals in the private sector and has begun to collect data on private-sector companies in the emirate to prepare for its increased regulatory responsibilities. Yet to be determined is whether the private system will require contributions by employers and employees or be funded solely with government contributions, as under the public-sector system.

Abu Dhabi is one of seven emirates in the UAE. Demographic studies predict that for the UAE as a whole, the share of the population over age 65 will rise from the current 4 percent to 12 percent by 2020.

Sources: *Gulf News*, February 21, 1999, and December 14, 2003.

Israel

As part of a general financial belt tightening, the Knesset, Israel's legislature, passed a law on January 7, 2004, increasing the age at which men are eligible for full retirement benefits from 65 to 67. For women, the normal retirement age will be raised from 60 to 62. The increase will be phased-in over 6 years by 4-month increments, through 2009.

The "Law for Raising the Pension Age" also provides for further increases in the retirement age for women to 64 by 2017. However, press reports since the bill's passage indicate that some supporters were unaware that this feature was in the reform. Some have called for reopening discussion on this portion of the bill, with the hope of passing remedial legislation.

Pension-related matters were a major area of conflict and negotiation between the government and organized labor for months in anticipation of the 2004 Israeli state budget and associated retirement-age bill. A 100-day work slowdown ended when labor and the government reached agreement, just days before the legislation passed.

Sources: *Financial Times*, January 8, 2004; *Haaretz*, January 2 and 8, 2004; *Israel's Business Arena*, January 8, 2004.

The Americas

Brazil

The Brazilian legislature passed social security reform for public employees in December 2003. The provisions of the law include the following:

- Raising the age of full pension eligibility by 7 years, to age 60 for men and 55 for women;
- Imposing an 11 percent tax on pensions;
- Lowering the benefit for new hires (under the old law, employees would receive 100 percent of their final year's earnings; the maximum benefit will now be limited to $820 a month); and
- Setting up a separate program of supplementary private pensions for new hires.

Brazil's current pension deficit is nearly 3.8 percent of GDP, 70 percent of which represents the civil servant pensions. The government expects this reform to save $17 billion over the next 20 years, with annual savings of about 0.165 percent of GDP.

To ensure passage of the reform by the end of December, the legislature removed some of the provisions in the bill and put them in a "parallel" amendment on social security reform for public employees to be passed separately. While the government has not issued any estimates of the fiscal impact of the additional provisions, the amendment is making its way through the legislature and includes the following:

- New salary caps for workers;
- Transitional rules for current employees, including relaxation of certain age requirements for those who retire before the reform is totally in force;
- Higher maximum benefit for disability pensions ($1,640 a month); and
- Tax exemption for disability pensions.

Sources: Fund Pro Latin America, December 14, 2003; Bloomberg, December 11, 2003; EFE News Service, December 12, 2003; *FIAP Boletín*, December 2003; *Wall Street Journal*, December 12, 2003; Dow Jones International News, December 12, 2003.

Colombia

According to Colombia's Social Protection Minister, Diego Palacio, the country's social security reserves could be depleted within the next 2 years, and the pension deficit over the next 50 years is projected to be two times GDP.

The government has already begun making changes to generate more revenue for the system. Beginning in February, contribution rates will rise gradually by 2 percentage points over the next 2 years—employers will pay an additional 1.5 percent (rising to 11.625 percent of earnings) and employees, 0.5 percent (rising to 3.875 percent of earnings).

In addition, the government is now proposing reductions in the "privileged" pensions for groups within the public system who receive higher benefits, such as congressmen, judges, teachers, and oil workers. Although President Uribe's proposal to cut these higher pensions was defeated by the legislature last November, he is determined to introduce another proposal in the near future.

Colombia's social security system, set up in 1993, allows workers a choice between the public pay-as-you-go program and an individual account managed by a private pension fund management company. Workers can switch from one system to the other every 3 years. Most of the country's 900,000 pensioners receive their earnings-related benefits from the public system. In 2002, 51 percent of the insured belonged to the public system, and 49 percent had an individual account.

Sources: Reuters News, January 8, 2004; Reuters-Noticias Latinoamericanas, January 8, 2004; Carmelo Mesa-Lago, "Panorama de los sistemas de pensiones de seguridad social en iberoamérica," 2003; Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2003* (forthcoming).

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