Europe

Romania

In June, the Romanian parliament passed a law establishing a system of mandatory individual accounts for workers under the age of 45. The accounts, which will supplement the existing pay-as-you-go system, are slated to take effect on July 1, 2006.

Under the new law, 2 percent of covered earnings initially will be redirected to individual retirement accounts from the current 35 percent employer-employee social insurance tax rate. This amount will gradually rise to 6 percent of earnings by 2014. Account contributions will be tax-deductible. Workers under the age of 35 will be required to join the new system, while for those aged 35 to 45 participation will be optional.

The Commission for Pension Fund Supervision will oversee the licensing of pension fund management companies, and specific regulations concerning their operation will come at a later date. The new law follows on the October 2003 provision that allows employers to set up tax-advantaged, voluntary employer-provided pension plans. (See also the November 2003 issue of International Update.)


Asia and the Pacific

Jordan

Jordan began the task of developing a uniform social security system in the 1990s in response to a declining ratio of workers to retirees and rapidly rising costs in its public employee pension systems. Beginning in 1995, all newly hired civil servants were required to join the SSC system, with the intention of phasing out entirely the civil service plan within 50 years.

The current reform follows a measure from 2002 that reduces the generosity of civil service pensions by increasing by 5 years the minimum length of service required to receive a pension. Previously men could retire with 20 years service and women with 15 years. The increase is being phased in through annual half-year increments.

Another series of pension reforms, implemented during 2003 and 2004, focused on reductions in military pensions, in part to satisfy performance criteria linked to a 2-year stand-by line of credit from the International Monetary Fund. In June 2003, the existing military pension system was closed to new recruits, who were instead enrolled in the SSC system. In 2004, eligibility criteria for disability pensions were tightened, and benefit levels were reduced.

The partially funded SSC system is mandatory for companies with five or more employees (in addition to new public-sector entrants) and voluntary for others. It covers about 16 percent of the working-age population (ages 15–59) and has a support ratio of contributors (462,000) to beneficiaries (68,000) of nearly 6.8 to 1. Projections in 1997 that SSC cash flow would fall below zero in 2028 and that assets would be exhausted in 2042 led the government in 2001 to increase contribution rates, tighten retirement eligibility rules, and establish an independent investment unit devoted to asset management. Although the SSC currently is running a large operating surplus with assets worth 24 percent of GDP, its long-term solvency is under a 5-year actuarial review. In 2002, SSC net assets were held primarily in bank deposits (51 percent) and equity holdings (27 percent). The government has announced that it plans to make further changes on the basis of the findings of the current review.
Taiwan

On June 11, Taiwan passed landmark pension legislation to create a national defined contribution system based on individual accounts. The new law transforms the existing retirement framework of nonportable, employer-specific defined benefit plans into a defined contribution plan managed by the central government. It also requires employers to fund their existing pension liabilities within 5 years.

Effective July 1, 2005, the Labor Pensions Act will require private-sector employers to direct 6 percent of payroll each month into a centrally managed investment fund with individual accounts for retirement savings. Employees may voluntarily contribute up to an additional 6 percent of pretax salary into the interest-earning accounts. The accounts will be portable, and there will be no vesting requirements. The Labor Insurance Bureau will act as record-keeper and custodian, monitoring and enforcing scheduled employer contributions. Companies failing to pay the compulsory contributions will face heavy fines. Although the new law provides little guidance on how the state-controlled assets will be invested, the government will guarantee a minimum annual return above the 2-year savings deposit rate.

Historically, Taiwan has relied on traditional family arrangements to provide a de facto social security system. However, an aging society and the weakening of family bonds have begun to undermine this social safety net. Today, nearly 9 percent of the population is aged 65 or older. The proportion of the elderly will increase to 10 percent by 2011 and could approach 30 percent by 2051, according to government projections.

The current defined benefit system for private-sector workers is governed by the 1984 Labor Standards Law, which mandates that employers contribute between 2 and 15 percent of employee salaries each month into a special account, managed by the Central Trust of China. Assets totaled TWD325.9 billion (US$9.7 billion) at the end of 2003. Despite universal employer coverage, retirement benefits are often inadequate or nonexistent. One reason is that the law does not require companies to fully fund their pension liabilities. As a result, only 10 percent of covered employers actually make contributions. In addition, many workers lose their benefits when changing jobs. Employees must work at the same company for at least 25 years if retiring before age 55 or a minimum of 15 years if retiring later.

The new law requires all new labor force entrants to join the new individual account system. Current employees will have up to 5 years to switch to the new system without affecting past service benefit accruals. The normal retirement age will rise from 55 to 60 years, and an annuity will be available after 15 years of service, with lump sums payable to those with fewer years. The individual accounts will be portable, there will be no vesting requirements, and benefits will be taxed as income when accessed—a feature that should encourage the selection of monthly pensions over lump-sum payments.

The business community is concerned about the financial ramifications of the provision requiring all employers to fully fund their past service obligations within 5 years on the basis of actuarial valuations. The vast majority of Taiwan’s employers are small- and medium-sized enterprises, and it is estimated that nearly 9 out of 10 have failed to set aside pension funds. To comply with the new law, employers would need to come up with as much as TWD2.6 trillion (US$77.4 billion), a figure that many fear would result in layoffs and wage cuts.


The Americas

El Salvador

In an effort to encourage later retirement and boost individual account balances, the government has established a minimum retirement age of 60 years for men and 55 for women, to be phased in between 2005 and 2009. Currently, a worker with 30 years of contributions may retire at any age.

Under current law, the government provides a guaranteed minimum pension, payable to men aged 60 or women aged 55 with 25 years of contributions whose account balance is not sufficient to finance a benefit at least equal to the minimum old-age pension set by law. The government calculates that keeping workers in the labor force longer will increase their ability to accumulate funds in their individual accounts.

The government has also approved a provision to refund an individual account balance at retirement if a worker has not met the minimum contribution require-
ments to qualify for a pension. A proposal was rejected that would have permitted a refund of account balances to foreign workers who leave the country before they are able to make the minimum number of contributions. According to the Association of Pension Funds, bilateral agreements may be necessary to allow portability of funds from one country to another.

In 1998, the system of individual accounts was set up, and the public pay-as-you-go system was closed to new entrants. Insured workers under the age of 36 in 1997 were required to join the new system, while participation was voluntary for those between the ages of 36 and 55 for men and 50 for women. Today, about 3 percent of the 1.1 million workers enrolled in the new system are aged 55 or older.

The pension system’s total assets currently represent about 12 percent of GDP. The Ministry of Finance estimates that this new provision would result in delayed retirement for some 27,000 workers between 2005 and 2009. The resulting budgetary savings would total US$100 million, or about 0.3 percent of GDP.


Peru

The Peruvian Congress approved overwhelmingly a law that will eliminate costly public pension benefits to some of Peru’s highest earners. The vote was 96 to 5, with 11 abstentions. As the proposed law involves a change to the constitution, it will require an additional two-thirds majority vote in the next legislative session, which begins in August.

Under the current cédula viva (“living decree”) law, certain government retirees, including former legislators, are eligible for a lifetime fully indexed pension equal to the current officeholder’s present salary. At the retiree’s death, the spouse and any unmarried daughters continue to receive the same benefit. The 2004 budget earmarked US$1.35 billion, or 2.2 percent of GDP, for the 300,000 pensioners receiving cédula viva and US$860 million, or 1.4 percent of GDP, for the 500,000 pensioners under the less generous general public system.

The proposal would eliminate the cédula viva for future retirees and would establish a benefit ceiling on current retirees with the highest pensions—only about 3 percent of current cédula viva retirees. The measure would save the government some US$90 million, or 0.15 percent of GDP, in benefits annually for current retirees and will reduce future benefits, especially for current legislators. The government plans to use the savings to increase benefits under the general public system.

In a separate measure passed in May, workers will have until July 2005 to file an application to switch from the individual account system back to the public pay-as-you-go system. A multisector commission made up of representatives from the Superintendent of Banking and Insurance, the National Pensions Office, the Pension Fund Management Companies, the Ministry of Economics and Finance, the People’s Advocate, and pensioners and account holders must approve the transfer. As of mid-May, 17,000 such applications were pending. Currently about 3.2 million workers have individual accounts, and about 150,000 workers are covered by the public pay-as-you-go system.

between the United States and Mexico fail to qualify for social security benefits from one or both countries because they do not meet minimum eligibility requirements. Under the agreement it will be possible for workers and their family members to qualify for prorated U.S. or Mexican benefits on the basis of combined credits from both countries. This will result in approximately 50,000 U.S. and Mexican workers receiving benefits after the first 5 years of the agreement.

The agreement must be reviewed by the U.S. Congress and approved by the Mexican Senate before it can take effect. The United States has similar social security agreements with 20 other countries, including Australia, Canada, Chile, South Korea, and nearly every country in Western Europe. In addition, the United States signed a social security agreement with Japan in February 2004, which is expected to take effect in late 2005. To find out more about agreements with other countries, go to http://www.socialsecurity.gov/international.


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