Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

February 2005

Europe

Portugal

Portugal has transferred €2.4 billion (US$3.1 billion) in assets from the pension fund of its state-owned bank, Caixa Geral de Depositos (CGD), into its general retirement fund to reduce the country's budget deficit. Portugal, like many other European countries, has maintained separate pension systems for its state-owned enterprises. The country's general retirement fund is considered part of the state budget and is a traditional pay-as-you-go system. CGD maintains a funded defined benefit pension system that was, until recently, separate from the state budget.

Initially, less than €2 billion was to be transferred, but on December 20, Eurostat, the European Union's statistical agency, rejected Portugal's use of revenue from leased-out government properties to reduce the budget deficit, prompting the government to transfer an additional €1 billion in pension assets from CGD coffers. Without the additional funds, Portugal's budget deficit would rise from 2.9 percent of gross domestic product (GDP) to 3.7 percent of GDP—breaking the 3 percent limit established by the EU Growth and Stability Pact. Although the transfer of pension assets has provided Portugal with a short-term fix to its budgetary problems, it may have done so at the expense of its long-term fiscal well-being. In exchange for the infusion of funds, the government will assume the liabilities for the bank's pension obligations.

Portugal is not alone in using pension assets from state-owned companies to show a one-time reduction in budget deficits. Last year both France and Germany assumed control of the pension assets and liabilities of several state-owned enterprises.

Sources: *Financial Times*, September 1, 2003; Dow Jones International News and Reuters News, December 23, 24, and 30, 2004; Social Security Administration, *Social Security Programs Throughout the World: Europe, 2004* (Washington, DC: SSA, September 2004).

Slovakia

On January 1, Slovakia introduced a system of individual accounts administered by private asset managers as a supplement to the public pay-as-you-go pension system. (See also the February 2004 issue of *International Update.*) Participation is mandatory for new hires and voluntary for those already in the labor force, except for workers who are within 10 years of retirement and will remain in the reformed public pillar only. The deadline for deciding to open an account is June 30, 2006. Depending on each worker's choice, combined employer and employee pension contributions—18 percent of earnings—will either be split evenly between the individual account and the public pillar or be allocated entirely to the public pillar. Today, about one million pensioners, approximately 19 percent of the population, receive benefits from the public system.

The state-run Social Insurance Institute directs the program, and, as of last December, eight pension fund managers and about 9,000 sales agents had been licensed. Each asset manager is required to offer three types of investment funds with varying degrees of risk—conservative, balanced, and growth-oriented. Slovakia will finance the reform in part through the sale of state-owned enterprises.

According to Deputy Minister for Labor and Social Affairs Miroslave Beblavy, the government expects about half of the 2.6 million eligible workers to choose an individual account by the end of 2005. Last October, the government launched an extensive advertising campaign to promote the new accounts. A November survey of a representative sample of 1,000 workers found that 59 percent agreed with the pension reform, 53 percent expressed an interest in individual accounts, 35 percent were still undecided, and only 12 percent wanted to remain under the public system.

Sources: CTK Daily News, October 20 and November 3, 2004; Slovakia News, November 11, 2004; Dow Jones International News, December 6, 2004; SITA, December 7, 2004; BBC Monitoring, January 2, 2005.

Africa

Namibia

The government has launched the Namibia Agricultural Retirement Fund to cover agricultural laborers, service providers, and people employed by agricultural training institutions. It is a funded defined contribution system with the contribution rate set at 10 percent, split evenly between employers and employees. Employers are also required to contribute an additional 1 percent of payroll for administrative fees. A special provision will allow contributions from international and nongovernmental organizations to enhance low pension benefits for older workers who have few years of contributions. A board of trustees will monitor the fund, with half of the trustees appointed by the Agricultural Employers' Association.

The fund will supplement the country's existing social pension, which pays an identical flat monthly benefit of N$300 (US$49) to all Namibians at age 60, regardless of need. That benefit is noncontributory and financed from general government revenues. Namibia's agricultural sector makes up 47 percent of the country's total labor force. Before the launch of the agricultural fund, only 20 percent of economically active Namibians had access to a retirement fund.

Sources: Central Intelligence Agency, *The World Factbook, 2004* (Washington, DC: CIA); "Namibia Agricultural Retirement Fund," http://www.agrinamibia.com.na, January 20, 2005; Wezi Tjaronda, "Agricultural Retirement Fund off the Ground," http://allAfrica.com, January 21, 2005.

The Americas

Uruguay

The government has permitted some older workers to switch from the system of individual accounts back to the public pension system. Workers who had opted for individual accounts and were at least 40 years old on April 1, 1996, when the new system was implemented, had from December 31 through January 10 to apply for a transfer. About 5,000 account holders, out of about 60,000 who were eligible, opted to switch back to the public system. Once a pension fund management company (AFAP) transmits the funds in a worker's individual account to the Social Security Bank, the worker will be credited with an equivalent number of contributions to the public system.

Uruguay has a "mixed" pension system with a public pay-as-you-go first pillar plus individual accounts as a second pillar. The individual accounts are mandatory for those earning above US$400 a month and voluntary for all other income levels. Approximately 650,000 workers, or 42 percent of the labor force, hold individual accounts in four AFAPs (three privately managed and one state run), with assets in June 2004 totaling US$1.3 billion, or 14 percent of GDP. About 60 percent of AFAP holdings are in government bonds; foreign investment is not permitted.

Despite an economic crisis in 2002 and subsequent debt restructuring that caused a significant drop in the value of assets in government paper, "the AFAPs have managed to maintain an 8 percent [real] return on assets from 1996 through 2004…" according to Juan Berchesi, president of the state-run AFAP República. (See also the March 2004 *International Update*.)

Sources: Business News Americas, April 15 and June 24, 2003, and January 4, 6,11, and 12, 2005; Latin American News Digest, January 21, 2004; Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2003* (Washington, DC: SSA, March 2004); Asociación Internacional de Organismos de Supervisión de Fondos de Pensiones, *Boletín Estadístico AIOS*, Número 11, Junio de 2004.

Asia

Japan

An advisory panel has proposed major changes in pension benefits for federal legislators, including a 70 percent increase in contributions and a 30 percent reduction in benefits. The legislature (Diet) is considering the panel's January 20 report, and legislation is expected to pass this year, with implementation likely to begin in 2006.

Last year's reform of Japan's national pension system increased contributions and lowered benefits for the general public, but it did not affect legislators, who have separate retirement provisions. (See also the May 2004 issue of *International Update*.) The annual cost of pension benefits for former lawmakers exceeds 3.3 billion yen (US$31.2 million). At present, 722 legislators in both houses of the Diet support 946 pensioners (retired members and survivors of deceased members).

The advisory panel, established by the Diet in 2004, has recommended integrating the legislators' pension plan with the national pension system. While preserving benefits for retired lawmakers and survivors of deceased Diet members, the panel suggested:

- Reducing state subsidies from the current 72.7 percent to 50 percent over 4 years, a level roughly in line with the subsidy expected for the national pension plan in fiscal year 2009;

- Raising each lawmaker's annual pension contribution by about 74 percent, from the current 1,265,605 yen (US$11,966) to 2,198,900 yen (US$20,789);
- Extending the period of service to qualify for a pension upon reaching age 65 from the current 10-year period in office to at least 12 years; and
- Cutting the minimum annual benefit by 33 percent from 4.28 million yen (US$40,446) to about 2.88 million yen (US$27,211). At the same time, benefits earned with each additional year of service would be capped at a maximum of 30 years of service instead of the current 50 years.

The political debate surrounding the recommendations is intergenerational as opposed to partisan. Older Diet members generally support changing the current system, and younger lawmakers are reported to favor abolishing the current arrangement and replacing it with an entirely new system.

Sources: *Kyodo News*, January 19, 2005; *Nikkei Report*, January 20 and 30, 2005; *Japan Times*, January 21 and 27, 2005; *Asahi Shimbun*, January 21, 2005; *Yomiuri Shimbun*, January 24, 2005; and *Daily Yomiuri*, February 3, 2005.

Thailand

The Finance Ministry has announced plans to convert the existing framework of voluntary provident funds into a mandatory centralized system. The proposal is the latest in a series of efforts to encourage retirement savings and would provide additional coverage for low earners. Details of the new system are expected to be announced in April, with implementation set for 2006.

Provident funds are the principal vehicle for long-term savings in Thailand, providing lump-sum defined contribution benefits to employees of organizations that choose to participate. Fund regulations currently allow public- and private-sector salaried workers to save up to 300,000 baht (US$7,845) per year, or 15 percent of their monthly salary, tax free. Employer contributions must at least equal those of the employee and are tax deductible as an employer expense, subject to a maximum limit of 15 percent of payroll.

The new mandatory funds would require a minimum contribution rate of 2.5 percent of salary from both employers and employees. The minimum rate is currently set at 2 percent of wages, having been reduced from 3 percent after the economic crisis in 1997. The Finance Ministry estimates that the 2.5 percent contribution rate could generate as much as 53 billion baht (US$1.4 billion) in new savings each year.

The Finance Ministry is also increasing savings options for independent workers and small businesses that do not participate in either provident funds or the social security system. For example, the government plans to expand current deductions for life insurance policies that allow investors to transfer money across savings funds without incurring tax penalties. In addition, the Cabinet approved a measure in 2004 to allow new tax incentives for the purchase of retirement mutual funds. Individual contributions of up to 300,000 baht (US$ 7,845) per year are now tax free, and there is no longer an age requirement for withdrawal if investments are held in the retirement accounts for at least 5 years.

Thailand has a pressing need to boost long-term savings. The Finance Ministry estimates that the government will require more than US$25 billion to build the nation's infrastructure over the next 5 years. In addition, most households have insufficient savings to meet their needs in retirement. More than 20 million of the 33 million people in the labor force do not participate in any long-term savings program.

Thailand's old-age income support system consists of three basic components: (1) the Social Welfare Fund, a mandatory pay-as-you-go system covering virtually the entire private nonagricultural labor force of about 7.7 million workers with reserves of 242 billion baht (US$6.3 billion); (2) the Government Pension Fund, covering approximately 2 million civil servants with reserves in excess of 240 billion baht (US$6.3 billion); and (3) provident funds, covering 1.5 million workers in private companies and certain state agencies with reserves worth about 293 billion baht (US$7.7 billion).

Sources: World Bank, *Pension Systems in East Asia and the Pacific: Challenges and Opportunities* (Washington, DC: World Bank, June 2000); International Benefits Information Service (IBIS), July and October 2000 and January 2003; Muang Thai Life Assurance Company, Ltd., *International Group Program (IGP) Country Profile, 2004: Thailand* (Boston, MA: John Hancock Financial Services, 2004); *Bangkok Post*, October 4 and November 10, 2004; *Nation* (Thailand), October 10, 2004; Thai News Service, October 8, 12, and 13, 2004; e-mail exchanges with officials in the Thai consulate (January 2005); fnWeb Daily News, "Finance Ministry set to launch new pension fund," January 14, 2005.

Uzbekistan

Parliament passed a law in December that sets up individual accounts as a supplement to the public pay-as-you-go system. The program, to be implemented this year, will be mandatory for employees and voluntary for the self-employed and farm workers. Employees will be required to contribute 1 percent of their earnings to an individual account, and their income tax will be reduced by the same amount. Additional voluntary payments by both employers and employees will be tax deductible. Although the registration of workers is scheduled to be completed by the end of March, the organizational structure and regulations for the new accounts are not yet established.

The state-run People's Bank will administer the individual accounts and, in agreement with the Finance Ministry and the Central Bank, will set an interest rate that is higher than the rate of inflation. The People's Bank has been granted an exemption from all taxes until January 1, 2008, to cover their start-up operating expenses. The Finance Ministry will approve the bank's investments.

Retirement benefits derived from the individual accounts will be payable either on a monthly basis or in a lump sum. If a worker dies before retirement, the survivor will receive the funds from the account in a lump sum. Workers will not be permitted to withdraw their funds for any purpose other than retirement income.

Under the existing public pay-as-you-go system, men qualify for a retirement benefit at age 60 with 25 years of covered employment and women at age 55 with 20 years of coverage. Employers contribute a total of 33 percent of payroll and employees 2.5 percent of earnings to finance old-age, survivors, and disability insurance and other programs, including sickness and maternity, work injury, and family allowances.

Sources: http://UZReport.com, December 22 and 23, 2004; Social Security Administration, *Social Security Programs Throughout the World: Asia and the Pacific, 2004* (Washington, DC: SSA, forthcoming).

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