Europe

**European Union**

On April 12, the European Parliament voted 551 to 81 to reform the pension system to eliminate disparities in salaries and pension benefits for its members. The vote was the result of recommendations in a report presented by Ona Juknevičiūnė, a Liberal Democratic member from Lithuania.

Members of the European Parliament are paid salaries commensurate with those of their home-country parliamentarians. However, the range of these salaries varies significantly across the parliaments of the European Union. The reform will equalize salaries and pension benefits for all members of the European Parliament.

The existing pension arrangement is a voluntary, contributory system. For simplicity of accounting, pension contributions are deducted from the members’ general parliamentary expense accounts. Members must reimburse these accounts out of their own pockets. However, no oversight system is currently in place to ensure that these accounts are actually reimbursed. Mrs. Juknevičiūnė also urged that pension contributions and the deficit be funded entirely by members rather than through government sources, but this amendment was voted down by 351 to 240, with 39 abstentions.

At the time of the last actuarial valuation for the pension system on December 31, 2003, liabilities outweighed assets by €41.7 million (US$54.2 million), and the funding level reached 76.4 percent. Despite the large shortfall, the system is considered sustainable at the moment since active contributors far outnumber beneficiaries. However, the outlook for the pension fund may weaken depending on the results of a future actuarial valuation.


United Kingdom

The Pension Protection Fund (PPF), established by the 2004 Pensions Act, began operations on April 6. The PPF was established to insure members of occupational pension plans against future insolvencies in much the same way that the Pension Benefit Guaranty Corporation does in the United States. However, many experts believe that the PPF’s fee structure for employers will not bring in sufficient revenue to cover future pension liabilities.

The 2004 Pensions Act also created a new Pensions Regulator with broad powers to police poorly funded plans, mismanagement, and fraud. The chairman, David Norgrove, has begun recruiting relationship managers to work with the roughly 580 employers representing 80 percent of private pension deficits in the United Kingdom. The Pensions Regulator has the task of ensuring that employers are adequately funding their pension plans without unduly burdening British industry, as well as the authority to force companies to make contributions if they are delinquent.

In the wake of several scandals regarding the sustainability of private pension systems, the government launched an investigation of the role of actuaries in the pensions industry. Sir Derek Morris led the investigation, and a report was subsequently issued on March 16 recommending greater competition among actuarial firms and an independent oversight. Morris also recommended the creation of an Actuarial Standards Board to supervise actuaries. The board would report to the government’s Financial Reporting Council. Most of the report’s recommendations have been welcomed by the actuarial community.


Asia and the Pacific

Pakistan

The Securities and Exchange Commission of Pakistan (SECP) finalized rules for a new, voluntary pension system on February 25 with an expected...
launch date of July 1, 2005. Under the new system, individual pension accounts will be managed by professional fund managers, and participants will receive annuities at retirement. Individual account balances will be invested by licensed pension fund managers according to criteria established by the SECP. Both asset management companies and life insurance companies are eligible to apply to the SECP for licensing as managers.

Citizens over the age of 18, who possess a valid national tax number and who do not have access to an approved occupational retirement plan, will be eligible to contribute into individual accounts managed by a private pension fund of their choice. Tax-preferred contributions will be subject to a ceiling of up to 20 percent of annual income, and participants will be permitted to transfer their account balances among pension funds.

The retirement age will be left to the worker’s discretion but must occur between the ages of 60 and 70. At retirement, account holders will be allowed to withdraw as much as 25 percent of their balance as a lump-sum payment. They will then be required to use the remainder either to purchase an annuity contract from an authorized life insurance company or to enter into an agreement with the pension fund manager to receive monthly installments up to the age of 75. Any remaining balance at the end of the phased withdrawal must be converted into an annuity. Barring special circumstances such as disability, early withdrawals from the accounts will be subject to an income tax penalty.

In 2000, Pakistan began a series of financial reforms designed to strengthen the banking sector and assist in the privatization of state-owned companies. Since 2003, private pension fund development has been a major objective. The Asian Development Bank required the establishment of private pension funds as a condition for a loan of US$250 million to support capital market reforms. In January 2004, a taskforce of experts recommended the adoption of fiscal and regulatory incentives to expand private pension coverage to workers not yet covered by an employment-related retirement plan.

The Ministry of Finance has been working to develop a pension fund based on individual accounts into which new public-sector employees would contribute 10 percent of their basic earnings with an equivalent amount to be matched by the government. The new pension plan would be mandatory for new hires but optional for current employees.

About 700,000 Pakistani public-sector employees participate in a defined benefit pension program, and the social insurance system, which is funded by employers and the government, covers another 1.64 million indus-

trial workers. However, the vast majority of the Pakistani labor force, roughly 42 million, does not participate in any old-age benefit program.

Pakistan does not face a demographic problem. The proportion of the population aged 65 and older, currently about 4 percent, is not projected to change through the year 2020. However, the government has been under pressure from donor agencies, including the International Monetary Fund and the World Bank, to take steps to reduce what are described as substantial pension liabilities associated with the civil service retirement system and the social insurance program. Current annual pension expenditures for the military and government employees are approaching PKR50 billion (US$842 million), about 0.8 percent of GDP, and social insurance and welfare expenditures account for an additional PKR4 billion (US$67.3 million).


Taiwan

The government has announced plans to replace a patchwork of insurance plans, pension funds, and government allowances with one unified retirement benefit system. The proposed consolidation would provide the country’s aging society with an economic safety net and help limit future pension obligations by capping government subsidies at current levels. The Ministry of State is drafting the reform legislation. Once the plan has been finalized, passage of the necessary laws and regulations to make the system operational could take at least 2 years.

Nearly 9.5 million Taiwanese workers—civil servants (including teachers), military personnel, and private-sector employees—are covered by some type of pension or social insurance program. Workers between the ages of 15 and 60 in firms with five or more employees, most public employees, and some self-employed persons participate in a social insurance program that provides lump-sum payments at retirement. Government workers and military personnel receive additional monthly pensions. There are also mandatory employment-related pension funds that provide retirement benefits for the
vast majority of employees in the private sector. At the same time, however, some 2 million self-employed workers, farmers, and workers in small enterprises are not covered by any retirement plan.

Taiwan’s fragmented retirement system has created sizable disparities in the level of old-age benefits. Retirement benefits for civil servants and teachers can equal 80 percent of final salary, and the benefit for private-sector employees is scheduled to rise to about 50 percent of the average salary when individual retirement accounts managed by the new Labor Pension Fund (LPF) become available on July 1 (See also the July 2004 issue of International Update.) For those only eligible for social insurance, old-age benefits consist solely of modest lump-sum benefits.

Taiwan’s declining fertility rate and changes in the traditional family support system are undermining its ability to support its elderly population. The ratio of persons of working age to those aged 65 and older was 9 to 1 in 1995, but it is projected to decline to 3 to 1 in 2036. Today, Taiwan’s government pension liabilities, including lump-sum benefits and monthly allowances, amount to TWD97 billion (US$3 billion), or 6.9 percent of the annual budget. The government estimates that figure will rise to TWD200 billion (US$6.4 billion) over the next decade and reach TWD412 billion (US$13.1 billion) a year by 2050.

Beginning July 1, private-sector employees will be covered by a new system of individual accounts. Industry sources estimate that the total annual inflows from this new system could range from TWD150 billion to more than TWD300 billion (US$5 billion to more than US$10 billion). Within 3 to 5 years, these new funds could add as much as TWD1 trillion to the current government-administered pension fund, which currently holds TWD360 billion (US$11.4 billion). The Ministry of State is also considering a proposal to open up the social insurance and individual account systems to workers not yet covered by a retirement plan.

nounced that it will issue a new 30-year bond sometime this year.

Enthusiasm about the new long-term bonds, however, has not been universal. Some experts believe that the unpredictable nature of interest rates make this type of investment risky, as investors may find themselves locked into a below-market rate of return. Additionally, as the bonds are not protected from inflation, a spike in prices could greatly diminish their value.


European Union

On March 16, the European Commission released a green paper on the serious ramifications of demographic change in the European Union.

Between now and 2030, the number of working-age adults in the European Union (EU) is projected to fall by 20.8 million, or 7 percent. At the same time, the number of EU citizens over the age of 65 will increase by 40 million, or 50 percent.

The paper warned that these unprecedented demographic changes will severely affect the future economic health of the EU, if appropriate actions are not taken soon. Pension reform was singled out as a top priority for member countries, as the shrinking of the workforce and the growing number of pensioners will greatly increase fiscal pressure on state budgets. The need for education reform to provide the young with better employment opportunities was also cited as a high priority. The paper urged that measures be taken to create higher employment rates, particularly for women and older people, as well as to increase productivity for all workers “through economic reforms, research and innovation.” While the paper discussed the positive impact of increased immigration, it cautioned that immigrants will eventually add to a country’s pension liabilities when they retire.


Organisation for Economic Co-operation and Development (OECD)

The economics department of the OECD has concluded that the trend of increasing human life expectancy seems to be permanent. For some time, the OECD has urged most of its 30 member nations to take steps to address the long-term implications of their aging populations. However, a new working paper, issued on March 29, suggests that the fiscal and economic effects of aging may be more pronounced than initially assumed. The report contends that there is no evidence to suggest that increases in longevity will slow.

“Over the past century and a half, female longevity has increased almost linearly by 2.4 years per decade. Moreover, conditional life expectancy at higher ages has recently accelerated, though with a wide cross-country dispersion. Hence, the regular increase in longevity seems to be a permanent effect.” [p. 6; emphasis in the original]

The report presents a series of policy recommendations intended to lessen the economic impact of aging populations in member countries. These recommendations include raising retirement ages to keep pace with increases in life expectancy; instituting policies to increase retirement savings; and providing incentives for higher employment rates across all age groups.