Social Security

International Update: Recent Developments in Foreign Public and Private Pensions

July 2005

Europe

Cyprus

As part of Cyprus's European Union (EU) convergence program to improve its public finances, the parliament approved legislation on June 23 to raise the normal retirement age gradually for civil servants from age 60 to age 63. The new law will be phased in as follows: for those who turn 60 between July 1, 2005, and December 31, 2006, the normal retirement age will be age 61; for those who turn 60 between January 1, 2007, and June 30, 2008, the normal retirement age will increase to age 62; and for those who turn 60 on or after July 1, 2008, the normal retirement age will be age 63. The new law did not change current pensions and bonuses for existing civil servants and new hires.

Cyprus pledged to reduce its government deficit and improve its public finances by freezing wages and gradually increasing the retirement age for *all* public-sector employees, including civil servants, education workers, and workers in semipublic organizations. Unions representing education workers and semipublic organizations, however, have so far rejected the retirement age increases, so these workers are not yet covered by this new law. Public-sector workers make up about 15 percent of the country's labor force, and civil servants account for about a third of that number.

In Cyprus, all private- and public-sector workers participate in the first-pillar pay-as-you-go Social Insurance Fund (SIF), which is financed by contributions from employers, employees, and the state. Public-sector workers, including civil servants, education workers, and employees of semipublic organizations, are also covered by employer-financed occupational pension plans.

The SIF old-age benefit combines a flat-rate portion and a supplemental earnings-related portion. Under SIF, private-sector workers are eligible for full retirement benefits at age 65, though early retirement may be taken beginning at age 63. Until the new law passed, all public-sector employees were eligible for full retirement benefits at age 60 and could take early retirement from age 55—an option chosen by about 40 percent.

Increasing the retirement age for civil servants will help ease financial pressures on the pay-as-you-go SIF, which is currently running a deficit of CYP 2 billion (US$4.2 billion). Since 1985, pension expenditures for civil servants have risen substantially, from CYP 12.5 million to CYP 156.7 million (US$332.4 million) in 2003. They are projected to reach CYP 202 million (US$428.4 million) in 2012.

The Ministry of Finance predicts that more broad-based changes to the pension system will be required to forestall insolvency as early as 2011. According to the 2004 EU convergence program report, other pension reforms being considered include gradually increasing the SIF early retirement age for private-sector workers from 63 to 65 over the period 2005–2011, with the possibility of further increasing it to age 67; increasing public-sector employee contributions to match those of private-sector workers while decreasing the level of government contributions; changing the indexation of the basic flat-rate portion of the pension from wages to prices; and increasing from 10 to 15 the number of years required to be eligible for an old-age pension.

Sources: European Commission, *Study on the Social Protection Systems in the 13 Applicant Countries: Cyprus Country Study*, January 2003; International Monetary Fund, *Cyprus: Selected Issues and Statistical Appendix*, February 2003; Republic of Cyprus, Ministry of Finance, *Convergence Plan of the Republic of Cyprus: 2003–2007* (Nicosia, May 2004); European Industrial Relations Observatory On-Line (http://www.eiro.eurofound.eu.int), May 2005; *Cyprus Weekly*, June 3, 2005; *Cyprus Mail*, May 12, June 15, and June 24, 2005.

Asia and the Pacific

New Zealand

The New Zealand government has proposed *KiwiSaver*, a new voluntary savings plan designed to help workers save for retirement and assist first-time home buyers. According to the Minister of Finance, legislation to establish *KiwiSaver* will probably be introduced later this year, with a program start date tentatively set for April 1, 2007. The government will sponsor a national campaign to promote *KiwiSaver* and to increase the public's financial literacy.

KiwiSaver accumulations are intended primarily for retirement, although the program will allow a one-time withdrawal toward the purchase of a first home. Employers will be required to offer employees the option to join the *KiwiSaver* program; convert their work-place savings plan to a *KiwiSaver* plan by meeting all criteria; or apply for an exemption for their existing company savings plan provided that it satisfies standards regarding minimum contribution rate, availability, portability, and vesting. Employers will be permitted to contribute to employees' *KiwiSaver* accounts.

New employees will automatically be enrolled in *KiwiSaver* at a contribution rate of 4 percent of gross salary but will be allowed to opt out. Once enrolled, participants may increase their contribution rate to 8 percent. Although current workers or the self-employed will not be automatically enrolled, they will be permitted to open a *KiwiSaver* account by selecting a registered provider.

KiwiSaver plans will be administered by the government through Inland Revenue and available through approved fund providers. The *KiwiSaver* products will be regulated by the Ministry of Economic Development but will not have a government guarantee.

The government will make an initial contribution of NZ$1,000 (US$686) into each *KiwiSaver* account and will subsidize management fees for approved *KiwiSaver* products.

Through *KiwiSaver*, first-time home buyers with at least 3 years of program participation will be eligible for a deposit subsidy of NZ$1,000 (US$686) per year up to a maximum of NZ$5,000 (US$3,427) per individual or NZ$10,000 (US$6,853) per couple. Workers covered by a non-*KiwiSaver* employer savings plan will also be eligible for this first-time home buyer's subsidy but not for the NZ$1,000 up-front government contribution or fee subsidy.

Over the first 4 years of operation, *KiwiSaver* costs are estimated to be NZ$384 million (US$263 million) for the up-front NZ$1,000 payment to be given to each participant and for the ongoing management fee subsidy and NZ$109 million (US$75 million) for operational costs, including the financial literacy program. There will also be start-up costs of NZ$25.7 million (US$17.6 million) for Inland Revenue to implement the program plus additional capital expenditures of NZ$12.8 million (US$8.8 million) in 2005–2006 and NZ$14.8 million (US$10.1 million) in 2006–2007.

Participation in New Zealand's work-based savings plans declined from 22.6 percent in 1990 to 14.1 percent in 2003, and the government expects that the combination of *KiwiSaver* and a savings program established in 2004 for public-sector workers will reverse that trend. Over time, the government expects the *KiwiSaver* program to bolster its citizens' retirement security by encouraging personal savings to complement the government-sponsored social security system, called the New Zealand Superannuation.

The state pension is financed by general revenues and currently costs less than 4 percent of gross domestic product (GDP) annually. It provides a universal flat-rate monthly benefit—approximately one-third of the average net wage—to all people over age 65 who satisfy the residency requirements, that is, have at least 10 years' residency after age 20, including 5 years' residency after age 50.

By 2051, the percentage of New Zealand's population older than 65 will more than double, from 12 percent in 2001 to 26 percent. At the same time, the working-age population will fall from 65 percent to 58 percent.

To address the anticipated growth in pension outlays, the government established the New Zealand Superannuation Fund in 2002 to help prefund future pension expenditures, which are projected to reach nearly 9 percent by 2065. The fund is financed by putting aside budget surpluses of about 1.8 percent of GDP each year until 2010. From then until 2025, smaller deposits will be set aside, and beginning in 2026 the fund will be drawn down to help finance state pension costs. Fund assets are increasing at an annual rate of nearly NZ$3 billion (US$2 billion), and later this year they will total about NZ$6.3 billion (US$4.2 billion), or 4.2 percent of GDP. They are projected to exceed 10.6 percent of GDP by 2009.

Sources: Brian McCulloch and Jane Frances, *Governance of Public Pension Funds: New Zealand Superannuation Fund*, 2nd Public Pension Fund Management Fund Conference, World Bank, May 5–7, 2003; AMP Life Limited, *International Group Program (IGP) Country Profile, 2004: New Zealand* (Boston: John Hancock Financial Services, 2004); *National Business Review* (New Zealand), March 24, 2005; Watson Wyatt, *Superannuation Update: Budget 2005*, May 2005; New Zealand Ministry of Economic Development, *Securing Your Future*, May 2005 (http://www.securingyourfuture.govt.nz/default.asp); Watson Wyatt Worldwide, *Global News Briefs—New Zealand*, May 2005; http://www.beehive.govt.nz, May 19, 2005; *Otago Daily Times*, May 19, 2005; *Dominion Post*, May 20, 2005; Mercer Human Resource Consulting, "New Zealand Budget—Mercer's Review," May 20, 2005; Economist Intelligence Unit—ViewsWire, May 16, 2005; *The New Zealand Herald*, May 30, 2005; Association of Superannuation Funds of New Zealand (ASFONZ), *SuperNews*, June 2005; International Benefits Information Service (IBIS), June 2005; Pensions Policy Institute, *PPI Briefing Note* (No. 21), June 2005.

The Americas

Argentina

The government has decided to maintain the contribution rate paid by workers with individual retirement accounts at 7 percent of earnings for one more year. With mid-term legislative elections just 4 months away, analysts note that the government was reluctant to raise the contribution rate, which would lower the take-home pay for 10 million account holders (about 58 percent of the labor force). The contribution rate had been scheduled to increase to 9 percent in July and to 11 percent in October.

In late 2001, the total contribution rate for workers with an individual retirement account was lowered from 11 percent to 5 percent in order to boost worker's take-home pay during the economic crisis. (See also the November 2004 issue of *International Update*.) In February 2002, it was raised to 7 percent.

Argentina has a three-tiered retirement system:

1. A basic flat-rate benefit,
2. An earnings-related benefit from the pay-as-you-go public system, and
3. A choice between a benefit based on a privately managed individual account and an earnings-related benefit from the public system.

Workers who choose the public system for all of their benefits and do not have an individual account pay 11 percent of earnings. This contribution rate was also temporarily lowered to 5 percent at the end of 2001 but was reinstated soon after to provide needed revenue to the public system.

Depending on the type of enterprise, employers pay a combined rate of between 17 percent and 21 percent of payroll to the old-age survivors and disability insurance public system, family allowances, and unemployment program. Employers do not contribute to the individual retirement accounts.

Sources: Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2003* (Washington, DC: SSA, 2004) http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2002-2003/americas/index.html; SAFJP, "Memoria trimestral," enero-marzo 2005, http://www.safjp.gov.ar/SISAFJP/Publicaciones/Memoria; Asociación Internacional de Organismos de Fondos de Pensiones (AIOS), "Boletín Estadístico Número 12-Diciembre 2004", mayo 2005, http://www.aiosfp.org; Clarín (Argentina), 7 y 25 de junio de 2005, http://www.clarin.com; FIAP, "Recortes de Prensa," June 28, 2005, http://www.fiap.cl.

Brazil

The latest portion of social security reform for Brazil's public employees passed the final vote at the end of June. Since pension reform requires a constitutional amendment, both chambers of congress had to approve this measure by a 60 percent majority.

According to the new amendment:

- Certain civil servants hired between December 17, 1998, and December 31, 2003, will be able to retire as early as age 53 (men) and 48 (women) but with a reduced pension. All civil servants hired after December 31, 2003, must be age 60 (men) and 55 (women) in order to retire.
- The amount of the civil service disability benefit that is tax exempt will be nearly doubled to 5,016 reais (US$2,145 per month).

Even though the main focus of the amendment is on the separate system for civil servants, one provision introduces a new guaranteed benefit to be set up for unemployed spouses and low-income workers under the public pension system for private-sector workers. The contribution rate, minimum retirement age, and number of contributions required for this new benefit have not been determined.

In December 2003, Congress passed the bulk of the civil service pension system reforms, which raised the retirement age for public-sector workers, imposed a tax on public-sector pensions, and lowered the benefit for civil servants hired after December 21, 2003. (See also the January and September 2004 issues of *International Update*.)

Sources: Dow Jones International News, June 30, 2005; Reuters Focus, July 1, 2005; *Folha de São Paulo* (Brazil), July 7, 2005.

Colombia

In mid-June, Colombia's congress passed a modified social security reform package to help fund the ailing pay-as-you go system. The reform reduces the number of annual bonus payments to about 300,000 pensioners, caps benefits for higher earners, and eliminates *privileged* pensions (more generous pension benefits for certain occupational groups). The next step in the pension reform process is for Colombia's Constitutional Court to determine the constitutionality of the reforms.

The legislation, once put in force, would:

- Eliminate one of two annual bonus payments to pensioners with benefits higher than US$493 per month, beginning in July 2005. The government originally proposed eliminating the payment for all pensioners.

- Limit the maximum monthly pension to 25 times the minimum monthly salary (currently US$3,830) except for those who already have 750 weeks or 15 years of contributions and are eligible to retire before July 31, 2011.
- Abolish *privileged* pensions beginning in 2010 for members of congress, the state-owned oil company (Ecopetrol), the judiciary, the central bank, and other state-run institutions. Only the president and members of the armed forces will continue to receive *privileged* pensions.
- Accelerate to 2010 from 2014 the gradual increase in retirement ages from 60 to 62 years of age for men and from 55 to 57 for women.

Analysts estimate that these measures will save about 18 percent of GDP over the next 50 years compared with the original bill introduced last summer that had projected savings of about 22 percent of GDP. (See the August 2004 issue of *International Update*.) Despite these recent reforms, however, Standard and Poor's estimates that the country's pension debt will reach 200 billion pesos (US$86 billion) by 2055.

According to the Finance Ministry, the government will have to make up a shortfall of 13.76 trillion pesos (US$6.2 billion) this year and 14.65 trillion pesos (US$6.3 billion) next year for benefit payments to Colombia's 1.5 million pensioners.

Sources: Dow Jones International News, June 13 and 16, 2005; Reuters-Noticias Latinamericanas, June 16, June 21, and July 5, 2005; *Portafolio* (Colombia), June 17, 2005.

Reports and Publications

Organisation for Economic Co-operation and Development (OECD)

The OECD has recently released the first issue of *Pension Markets in Focus*, a newsletter covering funded pension plans for public- and private-sector employees. It will gradually expand its coverage to other issues such as pension insurance, contracts, and personal plans managed by banks and investment companies. Data in the publication cover trends over the 2001–2003 accounting period and are based on the recently published OECD classification of pension plans and pension funds. (See also the May 2005 issue of *International Update*.)

Source: Organisation for Economic Co-operation and Development, *Pension Markets in Focus* (Paris: OECD, June 2005), also available at http://www.oecd.org/dataoecd/46/2/35063476.pdf.

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