Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

October 2005

Europe

Macedonia

Anticipating the January launch of Macedonia's new individual account system, the two companies licensed to manage the second-pillar pension funds have hired nearly 1,000 sales agents and have begun their marketing campaigns to attract and enroll workers. Because of the absence of a mature capital market in Macedonia, for the first 10 years the law limits the number of asset management companies to two, and each company may form only one fund.

The First Pension Fund is owned by the country's largest bank, and the New Pension Fund is owned by the country's second largest bank and a Slovenian pension fund. Each management company may charge accountholders the following administrative fees:

- Up to 9.9 percent of the worker's monthly contribution (each company has decided to charge 8.5 percent)
- 0.05 percent of net assets in the worker's account per month
- A transfer fee (not yet specified; workers may switch from one company to another only after being a member with one company for 24 months)

Fund investments will be monitored by the Pension Supervisory Agency, and holdings will be limited to

- up to 80 percent in securities guaranteed by the National Bank of Macedonia or the Republic of Macedonia,
- up to 60 percent in Macedonian bank deposits and securities,
- up to 40 percent in domestic equities,
- up to 40 percent in approved Macedonian bonds and commercial notes, and
- up to 20 percent in foreign investments (in the European Union, Japan, and the United States).

Beginning in January, workers who first entered the labor force on or after January 1, 2003, will be required to join the new two-pillar system—a reformed pay-as-you-go first pillar plus a mandatory individual accounts second pillar. Participation in the new system will be voluntary for those employed before January 2003. However, workers with more than 5 years of service under the old system are being discouraged from joining the two-pillar system because they would receive a maximum of 5 years of credit for contributions under the old system, regardless of how long they had contributed. (See also the June 2004 issue of *International Update*.)

At retirement, workers under the new system will receive a first-pillar benefit and have the option of using their individual account balances either to purchase an annuity from an insurance company or to receive programmed withdrawals scheduled to guarantee income over the worker's expected lifespan. Lump-sum withdrawals will not be permitted.

Workers who become disabled may choose to receive a benefit based on the accumulated funds in their individual account. If these funds are insufficient to generate an adequate pension, workers may transfer all of their individual account funds to the pay-as-you-go first pillar and receive a disability benefit from that system.

Sources: SeeNews, September 20, 2005; FIAP Bulletin, August 2005; Agency for Supervision of Fully Funded Pension Insurance (MAPAS) Web site, September 21, 2005; *Pension Reform in Eastern Europe: Experiences and Perspectives*, 2004.

Portugal

Since early August, private-sector workers may no longer retire early from Portugal's pay-as-you-go retirement system. Previously, workers could qualify for early retirement benefits either at age 55 with 30 years of contributions or at age 58 if they were unemployed. (The normal retirement age will remain at 65 for men and women with 15 years of contributions.)

Reports from the Organisation for Economic Co-operation and Development and the International Monetary Fund (IMF) concluded that recent benefit formula adjustments had done little to improve the pension system's financial sustainability. Beginning in 2002, the basis for calculating benefits was changed from a worker's highest earnings during 10 of the last 15 years of employment to a worker's adjusted lifetime earnings. However, until 2017, pensions may be calculated according to either method or a combination of the two, whichever yields a higher benefit.

The Ministry of Labor and Social Security reported that pension expenditures for private-sector workers consumed 6.1 percent of gross domestic product (GDP) in 2000; that figure is expected to rise to 7.8 percent of GDP by 2075. The report also projected a system deficit beginning in 2016 and a depletion of the reserve fund as early as 2029. However, the IMF considers these projections too optimistic.

Today, about 18 percent of Portugal's population is aged 65 and over, but by 2050 that proportion is expected to grow to about 33 percent.

Sources: "Portugal, Selected Issues," International Monetary Fund, March 2004; "Ageing-Related Pressures on Public Finances," OECD Economic Survey of Portugal, 2004; Global Retirement and Financial Management (RFM) Update, September 2005; Decreto-Lei 125/2005; *Social Security Programs Throughout the World, Europe, 2004*; *World Population Ageing, 1950–2050*.

Asia and the Pacific

Fiji

The Fiji National Provident Fund (FNPF) Act was passed on June 1, 2005, to expand pension coverage, increase retirement savings, and allow the fund to diversify its predominantly Fiji government bond holdings to include more foreign investments. The new law broadens the definition of *employer* and *employee* and mandates that informal-sector workers participate in the provident fund system. It is expected that the inclusion of those workers will increase the fund's membership of 305,000 by an additional 20,000.

The new law also requires all workers to contribute weekly or biweekly, rather than monthly. The current contribution rate of 16 percent of gross wages—split evenly between employee and employer—will be increased to a maximum of 30 percent. The additional 14 percent contribution can only be paid by the employer and may be withdrawn by the employee with the employer's permission.

The fund's old investment policies were quite restrictive and limited investments to Fiji government bonds; holdings in the United Kingdom, Australia, New Zealand, and Canada; first mortgage loans on freehold properties with more than 50-year leases; and shares, debentures, and unsecured notes paying dividends 5 years in a row. The Reserve Bank's restrictions on offshore investments resulted in excess liquidity and limited investment opportunities.

The FNPF, worth nearly $3 billion in 2004, covers workers aged 15 to 55 who are not members of equivalent private plans. Fund members who have contributed for at least 10 years may elect to receive a monthly pension, and members with less than 10 years of contributions may get a reduced pension. Old-age benefits are paid at age 55.

Sources: *Fiji Times*, November 9, 2004, April 20, June 2, 3, 4, 2005; "Report of the Sector Standing Committee on Economic Services on the Fiji National Provident Fund (Amendment Bill 2005)," Parliament of Fiji Islands, March 18, 2005; *Social Security Programs Throughout the World: Asia and the Pacific, 2004*.

Africa

Malawi

On September 16, the Malawi government and trade union leaders negotiated an end to a week-long strike by 4,000 civil servants that crippled government activities in the capital of Lilongwe. The workers were protesting a revision to the pension benefit formula and other changes that would cut retirement benefits.

Last year, under pressure from foreign donors, the government initiated reforms to cut government spending and spur economic growth, which included a new wage policy for the civil service. This new pay structure would have resulted in a significant increase in unfunded pension outlays under the existing civil service benefit formula. Therefore, a revised formula was implemented in July. The new calculation method bases pension benefits and other entitlements on a worker's 5-year salary average rather than on final salary.

The benefit formula adjustment is expected to reduce pension costs from MK8 billion (US$64.3 million) to less than MK3.5 billion (US$28.1 million), thus keeping pension cuts within budget for fiscal year 2005. Additional measures to reduce future civil service pension outlays include the scheduled raising of the normal retirement age from age 55 to 60 and a proposed increase in the length of service required to retire from 20 to 30 years.

The Government Public Pension Scheme (GPPS), a noncontributory pay-as-you-go system, provides retirement and other benefits to civil servants. Malawi has no social security system for private-sector workers. However, the government encourages state-run and private-sector companies through favorable tax policy to provide voluntary occupational retirement plans. Most of these arrangements operate on a defined contribution basis through contracts with insurance companies.

A recent study by a private insurance company recommended a partial conversion of the GPPS to a funded system, and the government will consider such a scheme, once the full impact of the current reforms is determined. Public employees below the age of 35 would be required to enter a new funded plan, while older employees would remain in the old system. Administration and management responsibilities for such a funded system would be contracted out to the private sector.

Sources: "Malawi Country Position Paper," Malawi Ministry of Economic Planning & Development and Ministry of Gender, Community Services, and Social Welfare, Regional Workshop on Ageing and Poverty, October 29–31, 2003; *All Africa*, January 31, 2005; *Benefits & Compensation International*, April 2005; "Malawi: Staff Report," International Monetary Fund, August 2005; Nationalmalawi.com, August 17, 2005, via Global Action on Aging; Panafrican News Agency (PANA) Daily Newswire, September 9, 2005; *Sunday Times* (Democratic Republic of Congo), September 12, 2005; Associated Press, September 15, 2005; BBC, September 16, 2005; Ministry of Finance Web site, Projects, September 21, 2005.

Other News

On September 26, representatives from the World Bank, the Organisation for Economic Co-operation and Development (OECD), and ING (the Dutch financial services group) announced a new research partnership to evaluate the performance and efficiency of a number of funded pension arrangements around the world. The role of private pension funds has grown significantly in recent years, yet there has been little comparative research done on these systems. It is expected that this initiative will show how well client countries have implemented the advice of multilateral organizations.

Collection and analysis of data from a number of emerging economies, principally in Latin America and Central and Eastern Europe, and from some high-income OECD countries will commence in November. The research should provide insight into investment management practices and how administrative costs affect plan performance. Initial findings, due in mid-2006, will be shared through conferences, workshops, and publications.

This public-private initiative is inviting interested parties, including financial and public institutions, to participate in this and other studies. More information is available at the World Bank Web site at http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALPROTECTION/EXTPENSIONS/0,,contentMDK:20658306~pagePK:210058~piPK:210062~theSitePK:396253,00.html.

Sources: IPE.com, September 26, 2005; World Bank press release, September 26, 2005; *Pension & Benefit Daily*, September 28, 2005.

International Update is a monthly publication of the Social Security Administration's Office of Policy.

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SSA Publication No. 13-11712