Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

April 2006

Europe

United Kingdom

Responding to public debate, the Pensions Commission reaffirmed its earlier recommendations in a final report released April 4. (See also the December 2005 issue of *International Update*.) The commission found broad agreement that the combined voluntary private and state pension systems are in need of reform to provide greater old-age security. It highlighted newly published data that support its analysis in previous reports. For example, recent survey data show that the percentage of employers offering a pension plan declined from 52 percent in 2003 to 44 percent in 2005.

In its final report the commission reiterated the importance of taking an integrated approach to pension reform that includes encouraging greater private pension savings, raising the retirement age, and increasing spending on the basic state pension. The commission's principal reform recommendations are

- *A simpler, less means-tested and more generous flat-rate state pension.* The report noted that to achieve this objective, an annual increase of about 1.5 percent of gross domestic product (GDP) in public pension expenditure could be partially offset by increasing the retirement age from 65 to 68 by 2050.
- *A new National Pension Savings Scheme (NPSS) to cover all employees not covered by an employer-sponsored pension plan.* It would be financed by a contribution rate of 7 percent of employee earnings, with 4 percent contributed by the employee and 3 percent by the employer. Workers would receive tax relief of 1 percent. The state would act as a bulk purchaser of NPSS account administration and fund management services.
- *Provision of supplementary pensions through automatic enrollment (with the right to opt out) to encourage greater earnings-related pension savings.* The commission found a broad consensus that automatic enrollment would help increase pension participation rates.
- *A minimum compulsory employer contribution of 3 percent of earnings for employees accepting automatic enrollment in a pension plan or NPSS.* Business groups object to this measure because of its impact on labor costs, particularly for small firms. The commission estimated that such a mandate would increase annual labor costs for most firms by about 0.6 percent and by as much as 1 percent for the smallest companies. The commission has urged the government to find ways to lower costs for small employers.

The government plans to respond to the report in a White Paper later this year. The entire commission report is available at http://www.pensionscommission.org.uk/publications/2006/final-report/index.asp.

Sources: Pensions Commission, "Implementing an Integrated Package of Pension Reforms: The Final Report of the Pensions Commission," and press release, April 4, 2006; Bureau of National Affairs, *Pension & Benefits Daily*, April 6, 2006.

The Americas

Chile

On March 17, newly elected President Michelle Bachelet announced the appointment of an independent pension advisory commission to study and propose improvements to the country's 25-year-old mandatory individual retirement account system. The politically diverse 15-member panel is headed by former budget director Mario Marcel and includes experts in the fields of economics, law, and sociology as well as former public officials, among others.

The commission will address the following issues:

- *Expanding coverage*, especially among the self-employed, whose participation in the system is voluntary. Today, about 60 percent of the labor force, including fewer than 10 percent of the self-employed, is covered by the individual account system.
- *Increasing the level of contributions among current account holders*. The 2002 Social Protection Survey found that a typical worker contributes to the

system during only 52.4 percent of his or her working life. As a result, by 2020, a third of all account holders will have such low account balances that they could qualify for the guaranteed minimum pension, according to government figures.

- *Increasing the retirement age for women from 60 to 65 to equal the retirement age for men.* Pensions for women are on average 40 percent lower than those for men because women live longer and make fewer contributions to the system. A recent study estimates that if women worked and contributed longer they could increase the size of their pension by an average of 61 percent.
- *Increasing competition to lower costs.* In 2005, three of the six asset management companies (AFPs) controlled about 70 percent of all pension fund assets. The commission will consider whether to allow banks to administer pension funds.
- *Lowering administrative fees.* Workers contribute 10 percent of earnings each month to an individual account plus an average of 1.6 percent of earnings for administrative fees. Five out of six AFPs also charge an average monthly flat fee of 557 pesos (US$1.08).

Representatives from a variety of groups such as labor unions, the business community, the AFP industry, the financial and insurance sectors, research centers, and members of Congress have been invited to testify before the commission. A preliminary report will follow these hearings, and a final report with specific proposals is due by June 15. The Minister of Labor will present the proposals to the president by June 30.

Chile's individual account system has some 7.4 million account holders, and its US$75 billion in assets under management represents about 65 percent of the country's GDP. The system has undergone a number of changes since its inception 25 years ago, including broadening the investment options, increasing regulation of the annuities market, and raising the requirements for early retirement. (See also the October 2003, March 2004, and January 2005 issues of *International Update*.)

Sources: "Análisis de propuestas para aumentar la cobertura de trabajadores independientes en el sistema de AFP," agosto de 2004; "Sistema de AFP: Resultados últimos, Evaluación 2000–2005 y principales desafíos," Superintendencia de AFP, enero de 2006; *International Social Security Review* 59 (3–25), 2006; http://www.safp.cl/inf_afiliados/index.html; http://www.safp.cl/inf_estadistica/aficot/mensual/2006/01/01A.html; Dow Jones International News, March 17 and 20, 2006; latercera.cl, March 17 and 18, 2006; http://www.presidencyofchile.cl, March 17, 2006; *El Mercurio* (Santiago de Chile), March 22 and 30, 2006; Agence France Presse, March 29, 2006; The Fund Pro Latin America, March 29, 2006.

Asia and the Pacific

Azerbaijan

In March the parliament adopted a law to increase the minimum monthly pension benefit to equal at least the poverty level, currently 120 AZN (US$132), by 2008. Before this law was passed, about 720,000 of the 1.3 million pensioners received the minimum benefit of 30 AZN (about $US33). This year the minimum monthly benefit will increase to $45, and it will rise again to between $60 and $65 in 2007. This measure will be funded from the state budget, which has tripled over the past 3 years because of increasing oil revenues. For 2006, 29.42 percent of the public pension fund's revenue is expected from the state budget. Pensions will be indexed to inflation annually beginning in 2008.

Following up on 2001 and 2003 presidential decrees to improve the public pension system, these benefit increases are part a series of reforms to shift Azerbaijan to a new two-tiered pension system based on individual accounts. Since the beginning of this year, the government has been registering workers and employers for the new mandatory system that is to be introduced on January 1, 2007.

Azerbaijan currently has a single-tier public pension system that provides a full pension to men with 25 years of service at age 62, to women with 20 years of service at age 57, or to anyone with 45 years of service regardless of age. In addition to pension benefits, the system provides cash sickness and maternity benefits, work injury benefits, unemployment benefits, and family allowances. It is financed by employee contributions of 2 percent of earnings and employer contributions of 27 percent of payroll for nonagricultural workers and 23 percent of payroll for agricultural workers.

Sources: "Azerbaijan Republic: Poverty Reduction Strategy Paper Progress Report," International Monetary Fund, October 2004; *Social Security Programs Throughout the World: Asia and the Pacific, 2004*; UNDP Azerbaijan Development Bulletin, April 25, 2005; Today.az, October 19, 2005, and January 28, 2006; Baku Today, January 28 and February 8, 2006; AzerNews, February 2, 2006.

Japan

On April 1, the mandatory retirement age for private-sector employees began to gradually increase from age 60 to age 65. The requirements under this law, which was passed in 2004 to encourage private-sector employers to retain older workers, will be phased in from 2006 until 2013 and will complement the scheduled increase in the social security retirement age.

The decline in Japan's labor force, which began in 1998, will be further exacerbated by the large-scale retirement of workers from the post–WWII baby-boom generation. Japan's low fertility rate (1.4) and its high life expectancy at birth (age 78 for men and age 85 for women) have made it one of the world's oldest societies. Its aging workforce and expected labor shortages have caused many Japanese companies to encourage employees to work beyond the mandatory retirement age by introducing *continuing employment* programs under which workers officially retire at age 60 and then are rehired, generally at reduced wages.

To comply with the new law, firms with a retirement age below age 65 must implement one of the following measures:

- Gradually raise the company retirement age to at least age 62 in 2006, to age 63 in 2007, to age 64 in 2010, and to age 65 in 2013;
- Introduce a continuing employment program that will allow employees to work until age 65; or
- Eliminate company retirement age provisions altogether.

Large companies have been given a grace period of 3 years to comply with the new law, and small- and medium-sized firms have 5 years to comply. A recent government survey indicates that most companies expect to adopt a continuing employment program.

In Japan, most firms have a mandatory retirement age, which is often negotiated as part of a labor agreement. Mandatory retirement dates back to the 1920s, and since WWII many firms have set a mandatory retirement age of 55 for their employees. To promote the employment of older workers, a 1980 law provided incentives for firms to set their mandatory retirement age at no less than age 60, and many companies complied. A 1994 revision to this law, effective in 1998, encouraged employers to take steps to retain workers desiring to work until age 65. This measure is now mandatory.

The normal retirement age under Japan's two-tiered social security system is scheduled to rise in response to the declining labor force and the aging population. The eligible age for private-sector employees to receive a full pension under the Tier 1 flat-rate program is gradually increasing from age 60 to age 65. The normal retirement age for men is being phased in from 2001 to 2013 and currently stands at age 62. The normal retirement age for women will rise from age 60 to age 65 from 2006 to 2018 and is now age 61. The normal retirement age under the Tier 2 earnings-related program will be raised from age 60 to age 65 for men from 2013 to 2025 and for women from 2018 to 2030.

Sources: "Japan: Ageing and Employment Policies," Organisation for Economic Co-operation and Development, 2004; *Daily Yomiuri*, July 27, 2004, and March 20, 2006; AARP, November 2004; *Asian Wall Street Journal*, June 15, 2005; *Japan Economic Monthly*, September 2005; *Nihon Keizai Shimbun*, September 16, 2005; *Japan Spotlight Bimonthly*, November 1, 2005; *The World Factbook: 2006*, U.S. Central Intelligence Agency, 2006; Japan Economic Newswire, March 30, 2006; and personal communication, officials in the Embassy of Japan, April 2006.

Reports and Studies

The World Bank

On February 2, the World Bank released a report by its Independent Evaluation Group (IEG), *Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance*. Since 1984, the Bank has provided pension reform support in 68 countries through $5.4 billion in loans and credits and has produced more than 350 papers and publications on the topic. In most cases, the Bank's strategy was to replace at-risk public pension systems with multipillar systems: a first-pillar public system, second-pillar mandatory individual retirement accounts, and third-pillar voluntary accounts.

The IEG concluded that although the Bank has performed satisfactorily in many individual projects, the initial goals of reducing poverty in old age and increasing pension coverage have yet to be met. Reforms have contributed to improved short-term fiscal stability in many countries, but the report suggests that more changes are needed in the long term. In many countries that have set up multipillar systems, private pension funds are not well diversified. Other reform objectives in these countries, such as increasing saving rates and fostering more developed capital markets, have not yet been achieved. The report recommends that the Bank

- focus on reforms that maintain the basic structure of the client country's pension system and adapt assistance to that country's specific conditions, especially institutional weaknesses, before embarking on a major structural reform;
- set up a technical assistance plan in each country that includes "contribution collection, contributor database development, actuarial and policy analysis, and regulation of multi-pillar operations";
- conduct additional research on issues such as the income of the aged, the impact of corruption and

governance on pension regulation, the design of noncontributory systems, and methods of fostering development of and competition within capital markets; and

- improve both internal and external communication and coordination with other World Bank components and other international organizations involved in the reform process as well as the client country's agencies that are affected by the reform.

The report is available at http://www.worldbank.org/ieg/pensions/?intcmp=5248320.

Source: *Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance*, February 2, 2006, World Bank.

Social Security Administration

The Social Security Administration has released *Social Security Programs Throughout the World: The Americas, 2005*, part of a four-volume series that provides a cross-national comparison of the social security systems in 36 countries in the Americas. It summarizes the five main social insurance programs in those countries: old-age, disability, and survivors; sickness and maternity; work injury; unemployment; and family allowances. The other regional volumes in the series focus on the social security systems of countries in Europe, Asia and the Pacific, and Africa. The report is available online at: http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2004-2005/americas/index.html.

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