Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

September 2006

Europe

Gibraltar

The 2007 budget, presented to the legislature on June 28, includes measures to eliminate social security contributions for citizens aged 60 or older and to change the tax treatment of occupational pensions. These provisions are part of a government effort to reduce payroll and income tax rates for workers and to increase net retirement income.

The proposed 2007 budget includes the following measures:

- Providing an income tax exemption for occupational pensions to persons aged 60 or older.
- Eliminating the requirement for retirees to use 75 percent of their defined contribution pension assets to purchase an annuity. According to Chief Minister Peter Caruana, annuities are difficult to obtain in Gibraltar and are seldom worth their high costs.
- Allowing full tax exemption for lump-sum benefit payouts instead of the current limit of 20 percent.
- Eliminating workers' social insurance contributions for those aged 60 or older. Employers must continue to make contributions for all employees.
- Increasing the means-tested minimum income guarantee for the elderly from £5,106 (US$9,700) per year for a single adult to £5,356 (US$10,176) and from £6,812 (US$12,940) per year for a married couple to £7,150 (US$13,584).

The government will consult with unions and employer organizations on adjusting social insurance contribution rates to encourage part-time work and changing the social insurance earnings test to encourage pensioners to work.

The legislature expects to vote on the proposed budget this fall. If passed, it will become effective retroactively from July 1, 2006.

Gibraltar's mandatory contributory social insurance system provides old-age, disability, maternity, and survivor benefits. Workers over age 18 contribute £1,079 (US$2,050) per year, and the self-employed contribute a flat rate of £1,247 (US$2,370) per year. Employers make annual flat-rate contributions of £1,362 (US$2,588) per employee. Old-age benefits are a flat amount of £2,485 (US$4,720) per year for a single adult and £3,728 (US$7,082) for a married couple. Citizens must make 156 weekly contributions at any time during their work life to qualify for the full old-age pension. Gibraltar's retirement age is age 60 for women and age 65 for men.

Sources: "Social Insurance Contributions: Guide for Employers," Ministry of Social Affairs, July 2005; Chief Minister's Speech, Office of the Chief Minister of Gibraltar, June 2006; Gibraltar News Online, June 23, 2006.

Greece

On August 3, the Greek government appointed an 11-member committee to develop a strategy for reforming the country's pay-as-you-go social security system. Government estimates project that the current pension deficit of 5 percent of gross domestic product will triple by 2050. The committee, drawn from representatives of government, industry, employers, and trade unions, is expected to issue its report in 2007.

Social security in Greece has evolved from a piecemeal system of occupational plans and today comprises a large number of state-run social insurance funds whose separate rules for eligibility, contributions, and benefits are widely perceived as inefficient and costly. There are 24 *primary funds* that provide health care and other benefits in addition to a pension. On average, the pension for workers with 35 years of service replaces about 70 percent of final-year earnings. Another 124 *auxiliary funds* provide supplemental pensions with an average replacement rate of 20 percent of earnings.

Generally, employees make pension contributions of 6.67 percent of earnings to primary funds; employers contribute 13.33 percent, and the government contributes 10 percent. Contribution rates for auxiliary funds typically equal 3 percent of employee earnings paid by both the employer and the employee. The normal retirement age is 65 for men and age 60 for women. However, according to a recent International Monetary Fund (IMF) report, the country's effective retirement age for

both sexes is 60.4 years, which ranks in the bottom third among European Union (EU) member countries.

The Labor Ministry has suggested that social security reform include

- Assigning national insurance identification numbers and creating a centralized database of employers and insured persons for all social security funds to address the problems of widespread contribution evasion and delays in paying benefits; and
- Merging several of the smaller social insurance funds into IKA, the country's largest social insurance fund for private-sector employees. In 2002, IKA introduced a computerized system for collections and recordkeeping to improve its administration.

The aging of the Greek population is projected to accelerate through the first half of this century because of continuing improvement in longevity (life expectancy at birth was nearly 77 years for men and over 81 years for women in 2005) and declining fertility rates (1.28 children per woman in 2003). During this time, the share of the population aged 65 or older is expected to double relative to that of the population aged 15–64, rising from 26.8 percent in 2005 to 55.8 percent by 2050. According to estimates from the Ministry of Finance and the IMF, without reform the country's pension expenditures are likely to reach 25 percent of gross domestic product by 2050.

Sources: "Greece: The Pension System," Obervatoire Social Européen, 2004; *Social Security Programs Throughout the World: Europe, 2004*; "The Greek National Strategy Report on Pensions," Greek Ministry of Employment and Social Protection, 2005; OECD, July 2005; *European Pensions & Investment News*, January 30, 2006; International Monetary Fund, January 2006; eiroline.com, March 2006; Athens News Agency, August 3, 2006; and ekatherimi.com, August 14 and 30, 2006.

Ireland

On August 8, the government released a report by Ireland's Pensions Board that examines the feasibility of adopting a mandatory supplementary pension system to address the country's low rate of private pension coverage. The report, "Special Savings for Retirement," was requested by Minister for Social Affairs Séamus Brennan and is a follow-up to the 2005 National Pensions Review. (See also the February 2006 issue of *International Update*.)

Currently, nearly half of Ireland's workforce (over 900,000 people) are without any private pension coverage and depend solely on the public, contributory old-age pension to sustain them in retirement. Today, that pension provides a flat-rate benefit that replaces approximately 30 percent of average preretirement income and is, according to the Organisation for Economic Co-operation and Development, the lowest replacement rate in Western Europe.

Using the mandatory pension systems in Australia, Chile, Singapore, Sweden, and Switzerland as potential models, the Board studied how implementation of these particular pension systems would affect retirement income, government finance, and the Irish economy as a whole.

The Board proposed the creation of a supplemental defined contribution pension system. Workers and self-employed persons who were not already participating in a government approved supplemental pension plan would be automatically enrolled in a "Special Savings for Retirement" account. Contribution rates for both employees and employers would reach 7.5 percent of earnings within 10 years.

The Board also recommended increasing the public pension benefit from approximately 30 percent of the average preretirement income to 40 percent over the next 10 years. According to the report, the proposed increase in public benefits in conjunction with demographic aging would create a projected unfunded public pension liability of 0.6 percent of gross national product (GNP) by 2016 before shrinking to 0.4 percent of GNP by 2046 and to 0.2 percent by 2056.

The Board cautioned that increased labor costs resulting from a new mandatory defined contribution pension system could negatively affect the country's competitiveness, discourage foreign direct investment, and reduce economic growth.

Sources: *Pensions at a Glance: Public Policies Across OECD Countries, 2005*; "Special Savings for Retirement," Pensions Board, August 8, 2006; Department of Social and Family Affairs Press Release, August 8, 2006.

The Americas

Chile

On August 9, Congress passed legislation creating two separate reserve funds to provide greater financial stability for future social program spending. The Pension Reserve Fund and the Economic and Social Stabilization Fund would be financed by a portion of Chile's budget surplus, which in the first half of 2006 equaled US$6 billion, or 4.2 percent of gross domestic product (GDP). The surplus is attributed to the country's recent record copper sales. Before becoming law, the bill must be approved by the Constitutional Court and the

President. Finance Minister Andrés Velasco expects the measure to be implemented by the end of the year.

The Pension Reserve Fund would bolster the future funding of the government's pension obligations, which are currently financed by general revenues. Although the government's benefit commitments under the old pay-as-you-go public pension system will gradually decrease as the system is phased out, additional funds will be necessary to help pay for the projected increase in guaranteed minimum pensions under the individual retirement account system. In addition, President Bachelet expects to expand the number of social assistance benefits paid to needy individuals. (See also the May and July 2006 issues of *International Update*.)

Depending on the size of the budget surplus, the Pension Reserve Fund would receive between 0.2 percent and 0.5 percent of GDP annually. Initially, the fund would receive almost US$600 million, or 0.5 percent of GDP.

For now, the Economic and Social Stabilization Fund would receive about US$4 billion to help finance programs such as education, health, and housing. About US$2.5 billion would be transferred from the current budget surplus. Another US$1.5 billion would come from closing the Copper Stabilization Fund, which was set up in 1997 to help cover budget shortfalls when the price of copper fell below projections.

Both the Pension Reserve Fund and the Economic and Social Stabilization Fund would be managed by a third party, to be chosen through an international bidding process. Chile's Central Bank would be included as a candidate to manage the funds. Both funds would be allowed to invest in domestic and international bonds and local and foreign currency but not in equities.

Sources: *Business Week Online*, September 27, 1999; Ministerio de Hacienda, Prensa, agosto de 2006; Camara de Diputados, Noticias, el 9 de agosto de 2006; Reuters—Noticias Latinoamericanas, el 11 de agosto de 2006; *Financial Times*, August 14 and 15, 2006; Dow Jones International News, August 14, 2006; *El Cronista Comercial*, el 16 de agosto de 2006.

Costa Rica

On July 6, the Costa Rican Social Insurance Fund Board (CCSS) approved special increases to the minimum contributory public pension and all pensions under the means-tested noncontributory program. Effective July 1, the minimum monthly contributory public pension, paid to about 43,000 pensioners, was increased by 18.8 percent, from 50,500 colones (US$101) to 60,000 colones (US$120). This increase reflects a special 13 percent adjustment in addition to the 5.8 percent increase in all contributory public pensions, part of the semiannual cost-of-living increase. This year the special increase will cost the government 4 billion colones (US$8 million); the regular adjustment, 5.4 billion colones (US$10.8 million).

The latest special adjustment to the minimum public pension is larger than those that were granted in 1998 and 2002. According to the General Manager of the Fund, José Alberto Acuña Ulate, special adjustments will now be made every 3 years to the pensions "that have lost the most purchasing power."

Costa Rica's public pay-as-you-go old-age, survivors, and disability system has 128,000 beneficiaries and 934,000 active workers. Of these beneficiaries, 34 percent receive disability benefits, 36 percent receive old-age benefits, and 30 percent receive survivor benefits.

The CCSS also doubled the means-tested noncontributory monthly benefits paid to more than 73,000 individuals who live in extreme poverty. According to CCSS Executive President Dr. Eduardo Doryan Garrón, this is the largest benefit increase for this program since its inception in 1975. Effective July 1, the new benefit levels range from 35,000 colones (US$70) to 45,500 colones (US$91), depending on the number of dependents.

Costa Rica's fiscal resources limit the number of individuals who may receive the means-tested benefit in any given year. Analysts estimated that in 2002, about 11,000 were on the waiting list to receive the benefit. The CCSS plans to expand the means-tested program over the next few years to cover an additional 400 individuals.

About 30 percent of the beneficiaries of the means-tested pension are disabled, and 1.4 percent are widows with children younger than 18; 65 percent are women older than 65. The program is funded in part by general tax revenues and special taxes on cigarettes and alcohol. The program's 2006 budget is 34 billion colones (US$68 million). The benefit increases are expected to cost the government an additional 8 billion colones (US$16 million) each year.

In 2005, the CCSS approved major changes to the first pillar pay-as-you-go public program that included raising the contribution rates and adjusting the benefit formula. (See also the May 2005 issue of *International Update*.) These measures are expected to be implemented in November 2006.

Costa Rica's second pillar consists of mandatory individual accounts. As of December 2005, about 1.4 million workers, or 30 percent of the labor force, had individual accounts with total assets of US$711 million, or 3.7 percent of gross domestic product.

Sources: *Social Security Programs Throughout the World: The Americas, 2005*; *Boletín Estadístico AIOS*, Número 14, diciembre de 2005; CCSS, "Resumen Asuntos Relevantes Sesiones Junta Directiva del 6 de julio del año 2006," julio de 2006; CCSS, Noticias, el 22 de agosto de 2006; *La Nación*, el 7 de julio de 2006; *El Financiero*, el 9 de julio de 2006.

Asia and the Pacific

Malaysia

On August 8, Malaysia's Employee Pension Fund (EPF) issued investment risk guidelines to private fund managers of the Members Investment Savings Scheme (MISS). The EPF is a national compulsory savings plan with a largely fixed-income investment structure that provides retirement benefits for all private-sector employees. The MISS, introduced in 1996, is an alternative EPF investment program consisting of approved, potentially higher-yielding mutual funds.

Each month employers must contribute 12 percent of an employee's salary to the EPF and employees contribute 11 percent. Participants with at least M55,000 (US$14,953) in their retirement account may transfer 20 percent of their account balance over M50,000 (US$13,596) to a MISS fund. At the end of 2005, M8.3 billion (US$2.3 billion), or 3.1 percent of EPF total assets, had been transferred to MISS funds.

The new guidelines for investment risk were issued in response to an August 6 *Mingguan Malaysia Weekly* report that over the last 10 years MISS investment fund losses were as high as M600 million (US$163 million). Under the new guidelines, all 42 MISS fund managers will be expected to:

- Improve the investment and risk management services offered to EPF participants;
- Increase the frequency of portfolio monitoring;
- Introduce low-risk suitable retirement savings products;
- Require their sales agents to promote investment products that match the risk profile of EPF savers and to clearly explain the particular financial risk of each product; and
- Reduce management fees for EPF investment products.

Tax-deductible EPF contributions plus accumulated interest are divided into three separate accounts for retirement (60 percent), home purchase or child tuition expenses (30 percent), and medical expenses (10 percent). Participants receive a guaranteed annual rate of return of at least 2.5 percent on their EPF savings, but there is no guarantee on MISS savings. When employees reach age 55—the earliest retirement age for men and women—the three EPF accounts are merged into a single account that will provide a lump sum, monthly installments, or a combination of both at retirement. At the end of 2005, total assets in the EPF system, including MISS assets, were approximately M264 billion (US$71.8 billion).

Sources: "The Malaysia Employee Provident Fund (EPF) 'Investment Scheme'—What Are the Rules?" Watson Wyatt, 2001; "IGP Country Profile: 2004 Malaysia," ING Insurance Berhad, 2004; *Social Security Programs Throughout the World: Asia and the Pacific, 2004*; Bernama—Malaysian National News Agency, July 17 and August 8, 2006; Dow Jones International News, August 7, 2006; *The Malaysian*, August 7, 2006; *New Straits Times*, August 8 and 9, 2006; AFX Asia, August 9, 2006; *The Star* (Malaysia), August 9, 2006; *Business Times*, August 14, 2006; and *Pension & Benefits Daily*, August 14, 2006.

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