Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

October 2006

Europe

Estonia

On September 26, the government requested that a projected 2006 budget surplus of 2.3 billion EEK (US$190 million) be transferred to the pension reserve fund. The reserve fund was initiated in November 2004 to offset projected shortfalls in the public pension system. It began with a deposit of the 2003 budget surplus of 532 million EEK (US$43.1 million) and was further supplemented with the full 2005 budget surplus of 1.8 billion EEK (US$146 million) in August 2006. Parliament is expected to vote on the 2006 budget this fall.

Estonia's shrinking ratio of workers to retirees is expected to strain the country's public pension system. In 2000, there were 4.7 workers for each individual aged 65 or older; the United Nations projects that by mid-century the ratio will be 2.1 to 1.

Estonia has a two-pillar public pension system. The pay-as-you-go first pillar was established in 1992 and currently provides both a monthly flat-rate pension of 1,001.41 EEK (US$81) plus a length-of-service benefit of 48.51 EEK (US$4) multiplied by the number of years of contributions made before 1999. It is financed solely by employers' contributions of 16 percent of payroll.

The second pillar, introduced in 2004, consists of funded individual accounts financed by employee contributions of 2 percent of payroll and a 4 percent contribution from employers. At retirement, account assets must either be used to purchase a life annuity or be taken through programmed withdrawals. Accounts are mandatory for workers born after 1982 and voluntary for those born between 1942 and 1982.

Currently, about a half million Estonians hold individual accounts managed by 15 licensed asset management companies. Second-pillar assets as of August 2006 were 6 billion EEK (US$486 million).

Men with 15 years of employment are eligible to receive retirement benefits at age 63, and women with 15 years of employment are eligible at age 59 and 6 months. Individuals may continue to work and receive full old-age benefits. Those who do not qualify for a first-pillar benefit receive a noncontributory National Old-Age Pension that provides a flat monthly benefit of 1,268.55 EEK (US$103) at age 63 for both men and women.

Sources: *The Baltic Times*, August 16, 2006; BNS News, August 28, 2006; *Social Security Programs Throughout the World: Europe, 2006*; Baltic Business Weekly, October 2, 2006; United Nations, *World Population Prospects: The 2002 Revision*.

France

The government recommended on September 14 that the pension provisions for state-owned enterprise (SOE) employees be aligned with other public pension programs to help reduce the growing national pension deficit. The report, issued by the public-sector auditor *Cours des Comptes*, concluded that the SOE pension plans, known as the *régimes spéciaux*, are unsustainable because of lower retirement ages and shorter contribution periods compared with those of other workers covered by social security.

The *régimes spéciaux* cover some 500,000 employees at state-owned companies such as the rail network, the Paris public transport system, the utility company Gaz de France, as well as the central bank. These employees retire earlier and with a higher pension than other workers covered by social security. In 2003, with the exception of SOE employees, France increased from 37.5 to 40 the number of years that civil servants must work to qualify for a full pension to match the social security requirements for private-sector workers. (See also the October 2003 issue of *International Update*.)

Currently, the normal retirement age for pension eligibility in the social security system is age 60; however, one-fifth of workers covered by the *régimes spéciaux* draw a pension before that age, some as early as age 50. In addition, some of these employees have their pension benefits calculated on the final 6 months of earnings instead of the highest 25 years, as is done for most workers in the social security system. The government finances shortfalls for the *régimes spé-*

ciaux, in some cases subsidizing more than half of the benefits received by those retirees.

Government officials plan to review the *régimes spéciaux* pension provisions following next spring's parliamentary and presidential elections, despite past opposition to pension reform. Widespread SOE trade union strikes forced the government in 1995 to withdraw its plans to increase the contribution period and lower benefits for civil servants and other public employees. Union opposition also helped ensure that the 2003 pension reform exempted SOE pension plans.

France's pension deficit grew from €75 million (US$100 million) in 2004 to €1.9 billion (US$2.2 billion) last year. The government predicts that despite the 2003 pension reforms, expenditures will grow from 12.8 percent of gross domestic product (GDP) in 2003 to 14.4 percent of GDP by 2020.

Sources: "The French Experience of Pension Reforms," Institut de Recherches Economiques et Sociales (IRES), September 2003; *Economist*, February 2, 2006; Reuters News, September 12, 14, and 26, 2006; *Financial Times*, September 13 and 16, 2006; Bloomberg, September 15, 2006.

Switzerland

On September 24, Swiss voters rejected plans to bolster the finances of the public old-age pension system (AHV) with profits from the Swiss National Bank (SNB). The initiative would have required SNB profits, except for 1 billion francs (US$787,000) earmarked for the 26 local government cantons, be paid into the AHV. Currently, SNB's profits are shared with the federal and cantonal governments.

Switzerland's form of direct participatory democracy allows for laws to be created or challenged through a referendum process. The proposed redirecting of SNB profits to the AHV required 100,000 signatures. Referendum supporters, including retiree groups, labor unions, and the Social Democratic Party, emphasized that redirecting SNB profits was necessary to avoid increases in pension contributions or benefit reductions. Opponents of the referendum, including the Swiss Parliament, the governing coalition, the SNB, and the banking industry, countered that the policy shift could threaten the central bank's independence and possibly undermine the stability of the franc.

Recently SNB profits have grown because of the bank's record gold bullion sales and favorable financial markets. With these profits, the bank pledged 2.5 billion francs (US$2 billion) to the federal and cantonal governments annually until 2012, when profits are projected to decline.

Social security old-age and survivor benefits are funded by contributions of 4.2 percent of gross earnings from employers and employees, government subsidies, and fuel and tobacco taxes. The AHV old-age pension system is currently able to cover its annual expenditures of around 31 billion francs (US$24.4 billion), but its financial situation is projected to deteriorate with the rapid increase in the number of pensioners (currently 1.7 million out of a total population of 7.4 million) over the next 2 decades. The government estimates that the pension system will require an additional 11 billion to 14 billion francs (US$8.7 billion to US$11 billion) by 2025 to remain solvent as the system's support ratio declines from today's 4 workers per pensioner to 2 workers per pensioner by 2050.

The Ministry of Finance has indicated it plans to propose legislation to transfer 7 billion francs (US$5.5 billion) from the sale of SNB gold reserves to shore up the AHV.

Sources: *Financial Times*, June 26, 2006; Dow Jones International News, September 21 and 24, 2006; Reuters News, September 22, 2006; Agence France Presse, September 24, 2006; Associated Press, September 24, 2006; *International Herald Tribune*, September 24, 2006; IPE.com, September 25, 2006; and *Pension & Benefits Daily*, September 26, 2006.

Asia and the Pacific

New Zealand

The KiwiSaver voluntary retirement savings account program became law on September 7. The program, approved by Parliament on August 30 and to be launched on July 1, 2007, will supplement the universal flat-rate public pension and provide a government subsidy to certain first-time home buyers. (See also the July 2005 issue of *International Update*.)

The new program permits anyone under age 65 to have a KiwiSaver account. Beginning July 1, workers between ages 18 and 65, whether new to the labor force or starting a job with a new employer, will be automatically enrolled. They will have from the second week to the eighth week of their employment to opt out. All other workers under age 65 may choose to set up a KiwiSaver account. The self-employed and those not in the labor force may also join the program by contracting directly with a plan provider. Individuals are permitted only one KiwiSaver account, but those with multiple jobs may make contributions from each.

The government provides no guarantee for the funds in these new savings accounts.

All workers may select a monthly contribution rate of either 4 percent (the required minimum and the default rate) or 8 percent of gross earnings and may make additional voluntary contributions. An employer may make part or all of an employee's contributions but will be allowed a tax exemption only on up to 4 percent of the employee's gross earnings.

Employers must withhold contributions until an employee opts out of the program, and those who do opt out will receive a refund of their contributions. The government will make a one-time tax-free payment of NZ$1000 (US$660) to each KiwiSaver account and provide an as yet unspecified partial subsidy for administrative fees.

After the first 12 months of membership, account holders may take a "contribution holiday" for a period of 3 months to 5 years at a time. In the event of a serious illness or a financial hardship, the contribution holiday may begin before the end of the first year. Also, some KiwiSaver plans and mortgage companies may allow those with at least 12 months of membership to divert up to half of their contributions to make mortgage payments.

KiwiSaver participants may withdraw all of their account funds when they leave the country permanently. They may also withdraw all but the government NZ$1,000 ($US660) payment before age 65 for:

- Serious financial hardship such as a member's or dependent's medical care, a dependent's education or the member's inability to meet minimum living expenses "according to normal community standards;" or,
- The purchase of a first home following at least 3 years of contributing to an account. Beginning in 2011, the government will also provide eligible first-time home buyers (subject to income and housing cost limits) with a deposit subsidy of NZ$1,000 ($US660) per year of KiwiSaver savings up to a maximum of NZ$5,000 ($US3,300) per person.

The Ministry of Economic Development will issue provider and plan regulations as well as approve all KiwiSaver registered providers including a limited number of default providers to be selected through a competitive process. Registered providers will be permitted to provide a variety of investment portfolios including conservative, balanced, or growth, but default providers will be limited to offering only plans with a conservative investment portfolio. Members may switch plans and portfolios at any time, and those who do not choose a registered provider and an investment profile will be assigned to a default provider. Inland Revenue, the central administrator, will collect employer contributions and distribute them to the plan providers.

Employers must provide access to a KiwiSaver plan to all employees by:

- Selecting the initial KiwiSaver provider for their employees who do not choose one;
- Converting its existing employer-sponsored superannuation retirement savings plan to a KiwiSaver plan; or,
- Requesting a government exemption for a registered superannuation plan that meets certain criteria including a limit on an employee's access to the funds and a minimum contribution rate of 4 percent of an employee's gross earnings.

The government predicts that about 25 percent of all New Zealanders aged 18 to 64, about 680,000 people, will have a KiwiSaver account by 2013. Based on these estimates, government program costs would go from NZ$53 million (US$35 million) in 2007 to NZ$211 million (US$139 million) in 2010. These costs include the government contribution of NZ$1,000 per member; the administrative fee subsidy; government agency implementation and operational costs; and financial and home ownership education programs. In addition, the revenue loss from the employers' tax exemption is expected to go from NZ$35 million (US$23 million) in 2008 to NZ$104 million (US$68.6 million) in 2010.

Sources: "KiwiSaver: Detailed Information," New Zealand Treasury, February 2006; tvnz.co.na, February 10, 2006; KiwiSaver Bill, February 28, 2006; *US Fed News*, February 28, 2006; scoop.co.nz, March 1 and 22, 2006; "Fact Sheet: Key Changes to KiwiSaver Bill," New Zealand Treasury, August 24, 2006; "KiwiSaver Questions and Answers," September 18, 2006; New Zealand Treasury, "KiwiSaver, Overview of the Scheme," September 2006.

Reports

The European Union

The European Commission predicts that the population of the 25 European Union countries (EU25) aged 65 or older will double between 1995 and 2050. The report was issued on September 29 to coincide with the United Nations' October 1st International Day of Older Persons, an annual event since 1991 to raise awareness of issues relating to the aged.

Eurostat, the European Commission's statistical office, reported that in 1995, 15 percent of the EU25 population was aged 65 or older, and by 2005 that figure had risen to 17 percent. At that time, both Germany and Italy had 19 percent, the highest proportion, and Ireland had 11 percent, the lowest share. Eurostat predicts that by 2050 the overall percentage of the population aged 65 or older will reach 30 percent, with Spain having the highest share at 36 percent and Luxembourg the lowest at 22 percent.

The report also noted that in 2003, among the 15 EU member countries for which data were available, men were expected to live 10.1 years of good health without disabilities after age 65 and women 10.7 years. Cyprus led with 12.6 years of good health without disabilities for men, and Italy had the highest number of years for women at 14.4 years. The lowest number of years of good health without disabilities after age 65 was 6.1 years in Hungary for men and 7.1 years in Finland for women.

The report also compared the EU25 2005 employment rate for workers aged 15 to 64 with that for older workers. The overall rate for those aged 15 to 64 was 63.8 percent compared with 26.7 percent for workers aged 60 to 64 and 8.2 percent for those aged 65 to 69. Sweden had the highest employment rate for workers aged 60 to 64 (56.8 percent) and Luxembourg had the lowest (12.6 percent). For those aged 65 to 69, the employment rates ranged from 28.4 percent in Portugal down to 2.4 percent in Slovakia.

Source: European Commission, *International Day of Older Persons: EU25 population aged 65 and over expected to double between 1995 and 2050*, September 29, 2006; United Nations, "International Day of Older Persons," October 2006.

Social Security Administration

The Social Security Administration has released *Social Security Programs Throughout the World: Europe, 2006*, part of a four-volume series that provides a cross-national comparison of the social security systems in 44 countries in Europe. 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 Asia and the Pacific, Africa, and the Americas. The report is available online at http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2006-2007/europe/index.html.

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