Social Security

# International Update:

Recent Developments in Foreign Public and Private Pensions

May 2007

## Europe

### *Germany*

**In March 2007, both houses of the German Parliament passed a law that increases the normal retirement age from 65 to 67.** This change is expected to reduce the financial pressure on Germany's unfunded public pension system by keeping its aging workforce employed longer. By 2030, Germany is projected to have just two workers to support each pensioner, compared with the support ratio of 4 to 1 in 1990. In 2005, Germany spent €236 billion (US$285 billion) on public pensions (for both the private and public sectors), or approximately 9.6 percent of gross domestic product (GDP). According to European Commission forecasts, these pension expenditures will rise to 12.3 percent of GDP by 2030 and to 13 percent of GDP by 2050.

Under the new law:

- The increase in the normal retirement age will take effect gradually at the rate of 1 month each year from 2012 to 2024 and in 2-month increments from 2024 to 2029. The phased increase in the normal retirement age will affect only those born from 1947 through 1963. Individuals born after 1963 will have to work until age 67; those born before 1947 will not be affected by the change. One exception, however, is that any worker who contributes for at least 45 years will still be able to retire at age 65 with a full pension benefit.
- Workers who have contributed for at least 35 years can retire as early as age 63, but with a reduction of 0.3 percent of the full pension benefit for each month they retire before the normal retirement age.

Germany has the lowest birth rate in Europe, with an average of 1.36 children per woman (well below the replacement rate of 2.1). The population decreased in 2006 as deaths outpaced births and the number of immigrants declined. According to the German Federal Statistics Office, the low birth rate and improved life expectancy at birth (76.2 years for men and 81.8 years for women) are expected to cause the population to age dramatically over the next 40 years. Government forecasts indicate that the current working-age population (aged 20–64) of 50 million persons could decline between 22 percent and 29 percent by 2050, depending on the extent of immigration. By 2050, the number of people aged 65 or older could exceed 30 percent of the total population, compared with nearly 19 percent at present.

On April 25, the German Cabinet approved the first increase in public pensions since 2003. Beginning July 1, pensions will rise by 0.54 percent for Germany's 20 million pensioners, at a cost of €1.2 billion (US$1.6 billion) annually. Public pension benefits have not increased in recent years because of their link to wage growth, which has remained largely stagnant. (See also the May 2005 issue of *International Update*.)

**Sources:** Federal Statistical Office Germany, various reports, 2006–2007; globalpensions.com, September 2006; Reuters News, February 25, 2007; Agence France Presse, March 9, 2007; Associated Press Newswires, March 9, 2007; Deutche Welle, March 9, 2007; Dow Jones International News, March 9, 2007; *Germans News Digest*, March 9, 2007; Expatica, March 30, 2007.

## The Americas

### *Mexico*

**A law passed by the Mexican Congress on March 31, 2007, will introduce an individual retirement account system for the country's public employees in 2008.** Under the law, new hires will be required to join the individual account system, and current public employees under age 46 may choose to join the retirement savings system or remain in the pay-as-you-go (PAYG) pension program for public employees. Public employees who switch to this new individual account program will receive a "recognition bond" that will represent the value of their accrued rights under the PAYG system.

Without reform, the pension deficit of the PAYG system is projected to grow from 0.5 percent of gross domestic product (GDP) in 2007 to 1 percent of GDP by 2012. From 1975 through 2005, life expectancy at birth in Mexico increased from 64.6 to 75.7 years and the average retirement age decreased from 61.9 to 55.

A newly created public institution called *Pensionissste* will manage the public employee's individual accounts for the first 3 years after the program is implemented.

In the 4th year, public employees will be allowed to switch to any of the pension fund management companies (AFOREs) that handle the private-sector individual accounts. *Pensionissste* will continue to manage the individual accounts for public employees who have not chosen an AFORE. Beginning in the 5th year of operation, public employees will be able to switch to another AFORE or back to *Pensionissste* once a year. *Pensionissste* will be directed by an 18-member executive commission of representatives from worker organizations and government agencies, such as the Secretary of Labor and Social Security and the Bank of Mexico, Mexico's Central Bank.

The administrative fees that *Pensionissste* charges account holders may not be higher than the average fees for all the AFOREs. The National Commission for the Retirement Savings System (CONSAR), which is the regulatory and supervisory agency for the individual account system for private-sector workers, will also oversee *Pensionissste*.

By 2012, a public employee's monthly individual account contribution will rise gradually from 3.5 percent of earnings to 6.125 percent, and the government's contribution as an employer will increase from 3.5 percent of the worker's earnings to 5.15 percent. All contributions will be paid on earnings of up to 10 times the minimum monthly salary. The current minimum monthly salary is about US$135. Public-sector workers with individual accounts will have to purchase separate survivors and disability insurance.

Under the individual account system, the government will guarantee a minimum pension equal to twice the minimum monthly salary to public-sector workers aged 65 or older with 25 years of contributions whose account balances would yield a retirement benefit below the minimum pension. Account holders whose balances at retirement will provide a pension greater than the guaranteed minimum may purchase an annuity or make programmed withdrawals based on life expectancy. Workers who do not qualify for the guaranteed minimum pension may either withdraw their funds in a lump sum or continue working until they are able to complete the required number of contributions. Public-sector workers may retire earlier than age 65 as long as their pension is at least 30 percent higher than the guaranteed minimum pension and they have life insurance coverage for their dependents.

Current retirees will continue to receive benefits from the PAYG system. By 2028, under the new law, the retirement age for current public workers who choose to remain in the PAYG system will increase gradually from age 50 to age 60 for men and from age 48 to age 58 for women.

Close to 3 million public-sector workers (about 7 percent of the labor force) contribute to the Social Security Institute for Public Employees (ISSSTE), which administers the PAYG pension and other benefit programs such as health care. The new law also makes changes to these other programs. About half of ISSSTE contributors are teachers, and some 580,000 pensioners receive ISSSTE retirement benefits.

**Sources:** World Bank, Report Number PID11126, "Mexico-Technical Assistance for Public Sector Social Security Reform (ISSSTE)," April 13, 2002; *El Norte*, el 15 de marzo de 2007; *Wall Street Journal*, March 26, 2007; *Diario Oficial*, el 31 de marzo de 2007; ISSSTE, "Preguntas Más Frecuentes Sobre La Reforma del ISSSTE," abril de 2007; Offnews.info, el 3 de abril de 2007; Economist Intelligence Unit, *Business Latin America*, April 9, 2007; Notimex, el 21 de abril de 2007.

## Asia and the Pacific

### *Philippines*

**In March 2007, 9 years after its introduction in the Philippine Parliament, the Personal Equity Retirement Account (PERA) bill became law.** Proponents of the new law claim it will encourage voluntary retirement saving and savings portability, promote capital market development, and generate long-term investments. To this end, a provident savings plan called the Personal Equity and Retirement Account will soon be established.

PERA contributors must be citizens of the Philippines, be of legal age, and hold a government-issued tax identification number. After January 2009, contributors will also enjoy a one-time 5 percent nonrefundable income tax credit. Contributors may own up to five PERA accounts; contributions made to each account will be tax exempt up to a maximum of 50,000 pesos (US$1,031) annually. Additionally, interest earned in PERAs and withdrawals made after the owner reaches age 55 will not be taxed.

A PERA contributor may receive a lump-sum distribution or lifetime monthly pension payments upon reaching age 55 and with at least 5 years of contributions. The law imposes early withdrawal penalties except in cases where PERA funds are used for accident- or illness-related expenses. Families of a deceased PERA contributor will receive the decedent's PERA account balance regardless of the contributor's age at the time of death.

The Department of Finance and the central bank will license an entity to manage PERA and invest funds in government securities, foreign currency deposits and investments, and nonspeculative stocks, with individuals making their PERA contributions through banks. Employers may also contribute to employees' PERAs as

long as both employers and employees comply with either the Social Security System (SSS) rules or Government Service Insurance System (GSIS) rules. These two systems are described below.

First, SSS is the Philippines' compulsory social insurance system that covers the majority of private-sector workers. With some exceptions, most workers earning at least 1,000 pesos (US$20.99) a month who are aged 60 or younger must participate in SSS. According to government officials, over 1 million SSS pensioners will soon receive a 10 percent increase in their benefit payments because of the plan's improved financial status. Officials say that SSS is in such good standing that increases in individual contributions will not be needed to pay for the benefit increase.

Second, public employees are covered by one of four compulsory retirement plans under GSIS, depending on their date of entry to federal service. At least for now, however, they will not receive the benefit increase that SSS participants will receive.

**Sources:** *Business World*, February 9 and 21, and March 6, 2007; *Manila Bulletin*, February 11, 12, and 22, 2007; *Asia Pulse*, February 22, 2007; *Social Security Programs Throughout the World: Asia and the Pacific, 2007*; Government Service Insurance System, April 17, 2007; *Manila Standard*, April 19, 2007.

## Africa

**On March 31, 2007, the governments of Burundi, Kenya, Rwanda, Tanzania, and Uganda approved a statute and constitution to establish the East and Central African Social Security Association (ECASSA).** Senior officials from the five governments met in January 2007 to propose ECASSA. Soon thereafter, work began on drafting the statute and constitution. The purpose of ECASSA is to provide a strong international voice for the pension systems in these five countries.

The five member countries envision ECASSA as an institutional forum for the exchange of ideas to improve their pension plans. Additionally, the governments will use ECASSA to facilitate portability of retirement benefits and provide a platform for greater cooperation on social security among the five countries. Together, member countries have a population of more than 100 million: 2.6 million are aged 65 or older, and about 66 million are between the ages of 15 and 64.

The retirement systems of all five countries are funded by contributions from employees based on gross monthly earnings and from employers based on gross monthly payroll. Burundi, Rwanda, and Tanzania each have social insurance retirement benefit systems that provide monthly pension benefits at retirement. Kenya and Uganda have provident fund systems that, upon retirement, pay a lump sum equal to total contributions and interest accrued rather than a monthly pension. These countries' provident funds also allow for preretirement distributions, generally for significant life events such as the purchase of a house, medical expenses, and education expenses.

The headquarters for ECASSA will be located in Nairobi, Kenya, initially and will most likely be moved to a permanent location in Kigali, Rwanda, after the next formal meeting scheduled in 2008. The five countries are also in the process of formalizing the East African Community (EAC) free trade zone and expect to sign that agreement on July 1, 2007.

**Sources:** *Social Security Programs Throughout the World: Africa, 2005*; *The New Times*, March 30 and 31, 2007; *Rwanda News Agency*, April 1, 2007; *East African Community*, April 18, 2007.

## Reports and Studies

### *United Nations*

**On March 13, 2007, the United Nations Economic Commission on Latin America (ECLAC) released a report titled "Changing Population Age Structures and Their Implications on Socio-Economic Development in the Caribbean."** This report examines the effect of the region's aging population on current and future development in 18 Caribbean nations.

Although Caribbean nations have relatively young populations, declining birth rates and recent advances in health care and social protection systems have contributed to population aging across the region. Consistent with trends in many other countries, the elderly population is a growing proportion of the population. According to recently released population figures, by 2050 the region's ratio of individuals aged 15–64 to those aged 65 or older is expected to decrease from 10 to 1 to 3 to 1. In some countries, including the Bahamas, Barbados, and Trinidad and Tobago, that figure is expected to decline by at least 70 percent by 2050. The fertility rate in 5 of the 18 countries is below the 2.1 replacement rate, and most of the other countries' fertility replacement rates are expected to fall below 2.1 within the next 10 years.

The report states that because of the relative youth of the region's current population, public pension systems are currently able to meet their financial obligations. However, as the population ages and the dependency ratio decreases, these public systems will probably require additional funding.

The report also indicates that about 30 percent of the region's population is living below the poverty line (below US$1 per day) in large part because of its inability to rebuild after recurring natural disasters. The largest poor populations are found in Guyana and Grenada and the smallest are found in Barbados and Jamaica. The elderly are among the poorest groups in the region.

Many Caribbean countries have noncontributory programs that provide a basic pension to those who do not qualify for any other type of pension. However, according to ECLAC, these noncontributory pensions and other social assistance benefits do not provide a "sustainable living." ECLAC warns that the many government-funded social assistance programs in the region will soon face funding shortfalls and should take action now to remedy this problem. Moreover, persistent tax evasion and a very large (about half of the population) informal sector in this region compound these Caribbean nations' fiscal problems.

The report's recommendations include the following:

- Collect data and implement monitoring and evaluation mechanisms to assesses poverty accurately.
- Expand social protection coverage by establishing contributory systems for informal-sector workers.
- Develop unambiguous policies on aging and better coordinate these policies among government agencies.
- Strengthen tax collection mechanisms to ensure the long-term viability of social protection financing.
- Create a three-pillar social security system with a noncontributory first pillar, a contributory second pillar, and an individual savings and retirement accounts third pillar.

The full text of the report can be found at http://www.eclac.org/publicaciones/xml/3/27113/L.98.pdf.

**Sources:** United Nations Economic Commission on Latin America, "Changing Population Age Structures and Their Implications on Socio-Economic Development in the Caribbean," March 2007; *United Nations News Service*, March 15, 2007.

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