Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

August 2011

This issue contains an occasional feature that provides a more in-depth look at changes to pension systems abroad. This month, the focus is on pension reform in Spain.

Focus on Spain

New Social Security Law

Spain's new social security law, enacted on August 1, increases the retirement age, the number of years of contributions required for a pension, and incentives for workers to remain in the labor force past retirement age. Most of the new rules will be implemented gradually beginning in 2013. The law also introduces an adjustment mechanism to the public pension system in 2027 to help control spending. Pension reform is part of the austerity measures the country is undertaking to reduce the government deficit. According to Eurostat, Spain's 2010 government deficit was about 9 percent of gross domestic product (GDP) compared with 6 percent on average across the euro zone.

Background

Spain has a single pillar earnings-related, pay-as-you-go public pension system that provides old-age, survivors, and disability benefits. A noncontributory means-tested benefit, financed by general revenues, is provided to individuals aged 65 or older who do not qualify for a contributory benefit. At present, a worker aged 65 or older may retire with at least 15 years of contributions, including at least 2 years of contributions in the past 15 years. An early old-age pension is paid to persons involuntarily unemployed beginning at age 61 with at least 30 years of contributions. In addition, workers eligible for retirement who switch from full-time to part-time employment may receive a partial pension. (The employer pays a reduced contribution on behalf of those workers.) Finally, a full old-age pension may be deferred from age 65 until age 70. That benefit is increased by 2 percent for each year of deferral and by 3 percent if the worker has at least 40 years of contributions.

Pension reform since 1995 is based on the Toledo Pact, signed by all political parties and the unions who commit to make necessary changes to maintain the country's public pension system. The first set of changes to the system through the Toledo Pact created a social security reserve fund in 1997 to help finance public pension deficits. At the same time, the number of years required for a public pension was raised and benefit adjustment according to increases in the consumer price index was introduced. Over the past decade, reforms further increased the minimum number of years required for a full retirement benefit and created penalties for early retirement and incentives to remain in the labor force beyond age 65.

Demographics and pension expenditures. The rapid aging of the population coupled with the system's relatively generous benefits are predicted to cause a significant financial burden on the system within the next 40 years. Spain's current older subpopulations (aged 65 or older and aged 80 or older) as a percentage of the total population are very close to the average among all European Union (EU) member countries. However, by 2050, Spain is projected to have a much older population than the EU member countries as a whole. The same comparison applies to the dependency ratio (see Table 1). In addition, the Organisation for Economic Co-operation and Development (OECD) calculates the gross replacement rate of a median earner in Spain (entering the labor force in 2008) as 81.2 percent, significantly higher than the OECD average of 57.3 percent. In 2010, expenditures on earnings-related public pensions accounted for about 10 percent of GDP. If there were no changes to the public pension system, the OECD estimates that pension expenditures could reach 15.5 percent of GDP by 2050, compared with 11.4 percent among OECD countries.

2011 Pension Reform

Spain's latest pension reform addresses these demographic challenges and focuses on parametric changes to the country's social security programs.

Table 1.
Aging population statistics in Spain and the European Union

Country	Percentage of population: Aged 60 or older, 2010	Aged 60 or older, 2050	Aged 80 or older, 2010	Aged 80 or older, 2050	Old-age dependency ratio[a], 2010	Old-age dependency ratio[a], 2050
Spain	16.8	31.5	4.9	11.3	4.0	1.7
European Union (average)	16.0	27.8	4.1	10.1	4.2	2.1

SOURCES: “Percentage of Population Aged 65 years and Over on 1 January of Selected Years,” “Percentage of Population Aged 80 years and Over on 1 January of Selected Years,” and “Old Age Dependency Ratio on 1 January of Selected Years,” Eurostat, June 2011.

a. The ratio of workers to retirees.

Retirement benefits. Beginning January 1, 2013, the new social security law will include the following:

- An increase in the normal retirement age from 65 to 67 by 2019—1 month per year until 2018 and then 2 months per year until 2027.
- An increase in the number of contribution years needed for a full pension, from 15 years to 25 years by 2022. The minimum remains at 15 years; however, a worker with 15 years of contributions will only receive 50 percent of the full pension.
- An increase in the number of contribution years required for workers with long careers, from 35 to 38.5 years by 2025. The retirement age for those workers remains at age 65.

Beginning in 2027, a “sustainability factor” will be introduced to the system that adjusts “the relevant parameters of the system” to changes in life expectancy every 5 years (no additional details are available).

Table 2 shows the government’s estimates of how much the measures related to retirement age, the required number of contribution years, and the sustainability factor will reduce pension spending. The OECD expects the increase in retirement age and contribution years to lower the replacement rate to 73.9 percent of previous earnings.

Table 2.
Savings as a result of social security reform, as a percentage of gross domestic product, by selected years

Year	Increase in retirement age	Increase in required contribution years	Sustainability factor
2030	0.8	0.5	0.0
2040	1.0	1.1	0.5
2050	1.0	1.3	1.0

SOURCE: “Spain: Adjustment, Reforms and Growth,” Government of Spain, March 11, 2011.

The law also allows voluntary early retirement (a reduced benefit) beginning at age 63 with at least 33 years of contributions. Also, in “crisis situations” (such as layoffs that are due to economic conditions or the death, retirement, or disability of a business owner) a worker with 33 years of contributions may retire at age 61. While partial retirement will be permitted for workers aged 65 or older (aged 61 or older depending on the number of years of contributions), the new law provides disincentives for this option by increasing the employer contribution on behalf of those workers.

On the other hand, incentives for older workers to remain in the labor force have increased. For every year an individual continues working beyond the full retirement age, the benefit will increase from 2 percent to 4 percent, depending on the number of years of contributions. For workers with less than 25 years of service, the incentive will remain at 2 percent; from 25 to 36 years, 2.75 percent; and, 37 or more years, 4 percent.

Survivor benefits. Survivor benefits for widows aged 65 or older who receive no other pension will increase gradually from 52 percent of the deceased’s base earnings to 60 percent beginning in January 2012. In addition, the age limit for eligible orphans will be increased from 18 to 21, and up to 25 for a student with income up to the minimum salary. Common law couples will be eligible for survivor benefits as well.

Other provisions. Additional provisions of the law include the following:

- Child care credits will be extended to a mother or a father who leaves the labor force to care for a child (biological, adopted, or foster). Previously, only mothers received credit toward a pension. From

2013 through 2019, the law will also gradually increase the number days of credit per child from 112 to 270.

- Domestic workers will be incorporated into the system beginning January 1, 2012.
- The State Social Security Administration (a supervisory agency created by the new law that incorporates a number of existing social security agencies including the National Institute of Social Security) will be required to inform each worker about his or her future rights to retirement benefits. The details will be determined by regulation, such as what age and how often the statement must be sent out and what specific information the statement must contain.

Sources*:* "Recent Developments in Spanish Pensions," Milliman Global Employee Benefits, September 2004*;* "Spain," *International Update,* US Social Security Administration, December 2007; *Social Security Programs Throughout the World: Europe, 2010,* US Social Security Administration; OECD Economic Surveys: Spain, OECD, December 2010; *Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries,* OECD*,* March 2011; "Spain: Adjustment, Reforms and Growth," Government of Spain, March 11, 2011; "Euroindicators," Eurostat news release, April 26, 2011; "Percentage of Population Aged 65 years and Over on 1 January of Selected Years," "Percentage of Population Aged 80 years and Over on 1 January of Selected Years," and "Old Age Dependency Ratio on 1 January of Selected Years," Eurostat, June 2011; *Spain––Staff Report for the 2011 Article IV Consultation*, International Monetary Fund Report No. 11/215, July 2011; Ley 27/2011, el 1 de agosto de 2011.

Europe

Greece

At the end of June 2011, Greece approved changes to social security as part of a 5-year (2011–2015) austerity plan to secure 12 billion euros (US$17 billion) in loans to meet the country's debt obligations through August 2011. Foreign lenders (European Union, European Central Bank, and International Monetary Fund) demanded passage of the austerity measures to enable Greece to avoid default.

Under the austerity package, cuts in social security benefits are expected to amount to 5.1 billion euros (US$7.3 billion), from 2011 through 2015. Key pension-related measures of the plan to reduce expenditures include the following:

- Expand means testing of the old-age social solidarity grant (currently based on income only) to include other assets.
- Reduce lump-sum retirement payments by at least 10 percent for civil servants and public enterprise employees, starting in 2011. (Future studies are expected to identify where these distributions may be out of line with contributions and identify possible adjustments to link these lump-sum amounts with contributions.)
- Extend the freeze on mandatory public pensions (approved in last year's pension reform and originally scheduled for the 2011–2013 period) to 2015.
- Reform the disability pension system (beginning in 2011) with the objective of reducing spending for disability pensions—now 14½ percent of overall pension spending—to 10 percent, with the government enforcing more rigorous (re)certification of disabilities and establishing a central evaluation office.

On the revenue side, the austerity plan calls for increases in social contributions amounting to 3.2 billion euros (US$4.6 billion) over the 2011–2015 period. Increased revenues are expected through employing the following measures:

- Full implementation of a single unified payroll and insurance contribution payment method intended to reduce evasion and to collect more social security contributions.
- An increase in contribution rates (details to be announced) for social security funds covering farmers and certain salaried professionals (primarily doctors, lawyers, and engineers).
- Establishment of a solidarity fund for self-employed beneficiaries.
- Introduction of unemployment insurance contributions for the self-employed and for public-sector employees (including state-owned enterprises, local government, and other public entities).

Despite past mergers of pension funds, the Greek retirement system remains complex and fragmented. Benefits are considered generous relative to wages and are often claimed before age 60. Critics assert that the benefit structure offers little incentive for older workers to remain in the labor force, especially for low-income workers, whose minimum pensions are not reduced for early retirement.

Sources: "Greece," *International Update*, US Social Security Administration, August 2010; *Hellenic Economic Policy Programme Newsletter: From May 2010 to May 2011*, Greek Ministry of Finance, May 19, 2011; "Greek Government Austerity Measures," BBC News, June 30, 2011; "Greece: Fourth Review under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria," International Monetary Fund, July 2011; "Greece Implements Austerity Plan Including Social Security and Health Spending Cuts," *Select News*, July 1, 2011; "Greek Government Austerity Measures," Reuters, July 4, 2011.

Ireland

In an effort to slow future pension costs and stimulate economic growth, in late June the Irish government enacted two laws that make a number of changes to the flat-rate state pension system (including an increase in the retirement age) and introduced a new 0.6 percent levy on occupational pension assets. The laws provide legislative backing to the financial bailout package agreed upon in December 2010 between the Irish Government, the International Monetary Fund, and the European Union.

Under the current system, the normal retirement age for a State Pension is age 66, but workers can receive a transitional State Pension at age 65 provided they meet all eligibility requirements, including retirement from employment and self-employment. The first law passed in June, however, eliminates the transitional State Pension as of January 1, 2014, thereby making age 66 the retirement age for all workers. In addition, the law increases the normal retirement age for the State Pension from age 66 to 67 by 2021 and from age 67 to 68 by 2028. The government committed to increasing the retirement age in the bailout package as well as in its *National Pensions Framework,* released in March 2010.

The first law also encourages further economic stimulus by lowering the employer contribution rate from 8.5 percent to 4.25 percent, from July 2, 2011, until the end of 2013. (This combined contribution finances the State Pension as well as sickness and maternity, work injury, and unemployment insurance.) The contribution rate for employees of 4 percent to 5 percent of earnings, depending on the level of earnings, remains the same.

The second law, which introduces a 0.6 percent levy on occupational pension assets, was passed in order to fund a new Jobs Initiative; the new initiative includes the creation of approximately 20,000 new posts and provides additional financial assistance and skills training. (Since 2007, there has been a significant increase in unemployment in Ireland, with registered unemployment rising from about 4 percent in 2007 to 14.3 percent in July 2011.) The levy is scheduled to run for an initial period of 4 years (2011–2014) and is expected to generate 450 million euros (US$644 million) annually, for a total of 1.88 billion euros (US$2.69 billion). According to pension industry estimates, some 65,000 current recipients of occupational pensions, plus an additional 700,000 workers covered by private-sector pension plans, will be affected by the new tax.

Sources: *Social Security Programs Throughout the World: Europe, 2010,* US Social Security Administration; "Ireland," *International Update,* US Social Security Administration, April 2010 and January 2011; Social Welfare and Pensions Act (No. 9) 2011; Finance Act (No. 2) 2011; Department of Social Protection press release (www.welfare.ie), June 2, 2011; "Live Register of Unemployed," Central Statistics Office, August 4, 2011.

Asia and the Pacific

China

The Social Insurance Law, which became effective on July 1, creates a national unified social security system designed to increase labor mobility within China. The new law contains important provisions that allow workers to transfer accrued rights from one program to another, cover foreign workers, and expand coverage to new segments of the urban and rural populations. However, the new law leaves many details to be resolved eventually through regulations; a timetable for finalizing regulations remains unclear.

Social security in China presently is governed by a national framework for workers in urban areas (pensions for old age, disability, and survivors; medical insurance; unemployment insurance; maternity benefits; and workers' compensation), but specific contribution rates and benefit provisions vary by city and/or province. The new law applies to employers and all individuals working in China. Individuals will be able to transfer their accrued rights to a social security pension and to medical and unemployment insurance benefits when moving from one province or city to another. As a result, individual participation in each local program is taken into account when calculating all years of service for any program nationally, regardless of where it took place.

The extension of social security coverage to foreign workers went into effect but without the benefit of implementing regulations, which could be several months away. An interim draft measure issued on June 10 did not clarify many issues, prompting some municipalities, notably Beijing and Shanghai, to issue their own regulations. Under the law, foreign workers are allowed to withdraw their own contribution amounts when permanently leaving China.

In implementing the new law, China's government also decided to accelerate the timing (from 2020 to 2013) of programs intended to expand basic pension coverage. To achieve this, the government adjusted its target for the rural pension pilot program (launched in 2009) from 40 percent to 60 percent coverage by the end of 2011, and it also introduced a new program for previously uncovered unemployed urban residents. The new rural pension program allows villagers aged 16 or older to contribute for at least 15 years to qualify for a pension. The urban program for those aged 45 or older is to be implemented in 60 percent of Chinese cities and townships by the end of this year, before being introduced nationwide in 2012; the program is funded by government subsidies and individual contributions.

Sources: "China: New Law in China Will Create a More Unified Nationwide Social Security System," Global News Briefs, June 2011; "Premier Wen Vows Tight Supervision over Pension Funds," Xinhua News Agency, June 21, 2011; "D-Day for Social Security," *China Daily*, July 1, 2011; "China Expands Statutory Pensions and Aims for System Convergence," *IP Asia*, July 7, 2011; "China's Rural Pension Program Covers 199 Million People," Xinhua News Agency, July 25, 2011.

Africa

Ethiopia

On July 8, new legislation went into effect that extends coverage to private-sector workers under Ethiopia's pay-as-you-go, earnings-related social insurance program. Previously, the program covered only public-sector workers, including military and police personnel. The regulations governing pensions for private-sector workers are identical to those governing public-sector pensions, but a separate, newly created agency (Private Organization Employees Social Security Agency) administers private-sector pensions. In the future, the government hopes to expand coverage in the program to workers in the informal sector (such as domestic workers).

Under the new legislation, contribution rates for private-sector workers are initially 5 percent of salary for employees and 7 percent for employers, but will increase by 1 percent annually until reaching 7 percent for employees (by 2013) and 11 percent for employers (by 2015). (Contribution rates for public-sector workers are already 7 percent for employees and 11 percent for employers.) To receive an old-age pension, workers (both in the public and private sectors) must be aged 60 or older and have at least 10 years of contributions. At retirement, the old-age pension is equal to 30 percent of a worker's average monthly salary in the last 3 years before retirement, plus 1.25 percent for each year of service exceeding 10 years (up to a maximum of 70 percent of the worker's average monthly salary).

Sources: *Social Security Programs Throughout the World: Africa, 2009*, US Social Security Administration; "New Pension Includes Private Sector," *Addis Fortune*, June 12, 2011; "International Headlines," *Mercer*, June 22, 2011.

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