Social Security

# International Update:

Recent Developments in Foreign Public and Private Pensions

March 2012

*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 Central and Eastern Europe.*

## Focus on Central and Eastern Europe

### *An Inventory of Pension Reforms, 2008 to Present*

Since the onset of the economic crisis in 2008, countries across Central and Eastern Europe (CEE) have adopted a wide range of pension reforms to address both short-term and long-term budgetary challenges. In the short term, the economic crisis exacerbated already high debt and deficit levels, which increased substantially from 2008 through 2010 almost universally across the region. In Hungary, for example, public debt increased from 72.9 percent of gross domestic product (GDP) in 2008 to 81.3 percent in 2010, while the deficit increased from 4.2 percent of GDP to 8.3 percent in this period. Similarly, in Poland, public debt increased from 47.1 percent of GDP in 2008 to 54.9 percent in 2010, while the deficit increased from 3.7 percent to 7.8 percent of GDP in the same period (see Table 1).

In addition, governments in CEE passed a series of laws to confront the challenge of rapid population aging and its effect on the long-term sustainability of their respective public pension systems. According to projections by Eurostat, the European Union's (EU) statistical office, the proportion of the population aged 65 or older will exceed 30 percent in almost all CEE countries by 2060. As a result, the old-age dependency ratio—the share of the population aged 65 or older relative to the share aged 15 to 64—is projected to fall from the current 1:4 to less than 1:2 by 2060 in most CEE countries (see Table 2).

This article provides an inventory of the pension reforms adopted in CEE to address these short-term

**Table 1.**
**General government debt and deficit/surplus in selected CEE countries, 2008 and 2010**

| Country | Public debt as a percentage of GDP | | Deficit/surplus as a percentage of GDP | |
|---|---|---|---|---|
| | 2008 | 2010 | 2008 | 2010 |
| Bulgaria | 13.7 | 16.3 | 1.7 | -3.1 |
| Czech Republic | 28.7 | 37.6 | -2.2 | -4.8 |
| Estonia | 4.5 | 6.7 | -2.9 | 0.2 |
| Hungary | 72.9 | 81.3 | -3.7 | -4.2 |
| Latvia | 19.8 | 44.7 | -4.2 | -8.3 |
| Lithuania | 15.5 | 38.0 | -3.3 | -7.0 |
| Poland | 47.1 | 54.9 | -3.7 | -7.8 |
| Romania | 13.4 | 31.0 | -5.7 | -6.9 |
| Slovak Republic | 27.8 | 41.0 | -2.1 | -7.7 |
| Slovenia | 21.9 | 38.8 | -1.9 | -5.8 |

SOURCE: Eurostat statistics database (http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes).

**Table 2.**
**Demographic aging statistics for selected CEE countries**

| Country | Percentatge of the population aged 65 or older | | Old-age dependency ratio [a] | |
|---|---|---|---|---|
| | 2010 | 2060 | 2010 | 2060 |
| Bulgaria | 17.5 | 32.7 | 25.4 | 60.3 |
| Czech Republic | 15.2 | 30.7 | 21.6 | 55.0 |
| Estonia | 16.8 | 31.5 | 24.7 | 56.4 |
| Hungary | 16.6 | 32.1 | 24.2 | 57.8 |
| Latvia | 17.4 | 35.7 | 25.2 | 68.0 |
| Lithuania | 16.1 | 31.2 | 23.3 | 56.6 |
| Poland | 13.5 | 34.5 | 19.0 | 64.6 |
| Romania | 14.9 | 34.8 | 21.4 | 64.8 |
| Slovakia | 12.3 | 33.5 | 16.9 | 61.8 |
| Slovenia | 16.5 | 31.6 | 23.8 | 57.6 |

SOURCE: Eurostat population projections (http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Population_projections).

a. The percentage of the population aged 65 or older relative to the proportion of the population aged 15 to 64, expressed as a percentage.

and long-term challenges, focusing on EU member states that have implemented significant reforms from the start of the economic crisis in 2008 to the present.

## *The Short-Term Challenge: Reduce Debt and Deficits*

In the decade from 1998 (Hungary) to 2008 (Romania), a majority of CEE countries implemented laws that replaced their old public pay-as-you-go (PAYG) pension systems with multipillar systems consisting of a less generous first-pillar public PAYG program and second-pillar mandatory individual accounts. (Of the 10 CEE countries that are now part of EU, only Slovenia has not adopted this model; the Czech Republic will launch a multipillar system in January 2013.) As a result of those reforms, a proportion of contributions that had been going to state-run PAYG programs was diverted to fund the privately managed individual accounts. At the height of the economic crisis, many CEE countries sought to rein in the growth of public debt and deficit levels—which should be less than 60 percent and 3 percent, respectively, according to the EU's Stability and Growth Pact—by bringing some of the mandatory individual account contributions back to the public programs. Key measures introduced across the region include (1) the reallocation of contributions from second-pillar individual accounts to first-pillar public programs, (2) a change in the mandatory nature of the second pillar by either introducing temporary "opt-out" periods or by permanently eliminating the second pillar, and (3) other temporary measures affecting the taxable ceiling and/or benefit levels of first-pillar PAYG programs.

### *Reductions/Reallocations of Second-Pillar Contributions*

Across CEE, a number of countries introduced laws that reduced contributions to second-pillar mandatory individual accounts and reallocated them to first-pillar public PAYG programs. Examples of those measures are provided for the following countries.

**Estonia.** A law implemented in June 2009 changed the employer contribution rate for second-pillar individual accounts from 4 percent of gross payroll to 0 percent in 2010, 2 percent in 2011, and 4 percent in 2012. Those contributions are drawn from the total employer contribution rate of 20 percent of gross payroll, with the remaining contributions diverted to the first-pillar program.

**Hungary.** A series of laws passed in late 2010 led to the most drastic reversal in the region, culminating in the effective elimination of the second pillar. In October 2010, a law was passed that temporarily suspended (through December 2011) all employee contributions to the second pillar and reallocated them to the first pillar. However, in December 2010, the government went a step further by (1) making that suspension permanent, and (2) automatically moving workers out of the second pillar, with their individual account balances transferred back to the first-pillar public program. While workers were technically allowed to remain in the second pillar, strong disincentives led to only 100,000 of the 3 million participants choosing to do so.

**Latvia.** A May 2009 law temporarily lowered the combined employer/employee contribution rate to second-pillar individual accounts from 8 percent to 2 percent, with the reduction diverted to the first-pillar public program. (In 2013, the contribution rate for the second pillar is scheduled to increase to 6 percent, with a proportional decrease in the first-pillar contribution rate.)

**Lithuania.** The second-pillar contribution rate was reduced three times since 2008: from 5.5 percent to 3 percent of gross salary in January 2009, from 3 percent to 2 percent in July 2009, and from 2 percent to 1.5 percent in December 2011. Those levels of contributions are drawn from a total employer/employee contribution rate of 26.3 percent, with the remaining contributions diverted to the first-pillar program.

**Poland.** A May 2011 law reduced the second-pillar contribution rate from 7.3 percent of the employee's monthly salary to 2.3 percent, with the 5 percent reduction being diverted to first-pillar subaccounts managed by Poland's social insurance institution (ZUS). The second-pillar contribution will rise gradually to 3.5 percent from 2013 through 2017, with the contribution to the first-pillar subaccounts decreasing proportionately.

### *Changes to the Mandatory Nature of Second-Pillar Programs*

A second approach adopted in CEE to reduce debt and deficits was to change the mandatory nature of the second pillar. Examples of that approach are provided for the following countries.

**Hungary.** An October 2010 law made participation in the second pillar voluntary for new entrants to the

labor force and allowed all existing members to opt out of the second pillar (from October 2010 through December 2011). Account balances for those choosing to opt out were transferred to the first-pillar PAYG program. (This law was made redundant with the December 2010 law discussed earlier.)

**Slovak Republic.** Laws passed in 2008 made participation in the second pillar voluntary for new entrants to the workforce and allowed workers to temporarily opt out of the second pillar (from November 2008 through June 2009). Account balances for those choosing to opt out were transferred to the first-pillar PAYG program. (In September 2011, participation in the second pillar was once again made mandatory for new entrants to the workforce, but with the possibility to opt out within the first 2 years of employment. Those who do not opt out must remain in the second pillar.)

### *Other Changes to Reduce Debt/Deficits*

Additional temporary measures were passed to reduce the fiscal burden of first-pillar PAYG programs. Examples of those measures are provided for the following countries.

**Latvia.** A law implemented in January 2009 removed the taxable limit on earnings for social security contributions for a period of 4 years, through December 2013. (Social security contributions are based on workers' entire employment-related gross income, including fringe benefits and stock options.) The law also increased penalties on employers for delinquent payment of contributions to the government.

**Slovenia.** Budget bills for 2011 and 2012 froze old-age pensions at the 2010 level. (An increase is possible for 2012, but only if inflation exceeds 2 percent.)

## *The Long-Term Challenge: Improve the Sustainability of Public PAYG Programs*

In addition to the measures to reduce public debt and deficits, the economic crisis also prompted countries to pass laws aimed at ensuring the sustainability of their PAYG programs in the face of rapid population aging. These measures include (1) an increase in retirement ages and in the years of contributions required to receive a pension, and (2) other parametric changes, including stricter rules for early retirement and the adoption of less generous methods for the indexation of old-age benefits.

### *An Increase in Retirement Ages and Contribution Requirements*

The primary approach adopted across CEE to improve the long-term sustainability of public PAYG programs was to increase retirement ages and/or the number of contribution years required to receive a pension. Examples of that approach are provided for the following countries.

**Bulgaria.** Retirement ages for men and women began a gradual increase in January 2012 from age 63 to 65 for men and from age 60 to 63 for women by 2017. In addition, the number of contribution years required for a full pension is increasing by 4 months a year for men and women from 2012 through 2020, from 37 years to 40 years for men, and from 34 years to 37 years for women.

**Czech Republic.** A January 2010 law increased the retirement age for men and women without children to age 65 by 2028. Women with children will be able to retire from ages 62 to 65, according to the number of children. In addition, the law also increased the number of years of covered employment required for a full pension, from 25 years to 35 years by 2019.

**Estonia.** An April 2010 law gradually increased the retirement ages for men and women from age 63 to 65 from 2017 through 2026. (A law that is currently being implemented is gradually increasing the retirement age for women to age 63 by 2016, to match that of men.)

**Hungary.** A June 2009 law increased the retirement age for men and women from age 62 to 65, by 6 months each year from 2012 through 2017.

**Lithuania.** A June 2011 law increased retirement ages from age 62.5 to 65 for men and from age 60 to 65 for women from 2012 through 2026.

**Romania.** A December 2010 law increased retirement ages from age 64 to 65 for men and from age 59 to 63 for women by 2030.

### *Other Measures to Reduce Cost of Public PAYG Programs*

Additional measures were introduced to improve the long-term sustainability of pension systems. Examples of those measures are provided for the following countries.

**Hungary.** A May 2009 law eliminated the 13$^{th}$ month pension (equal to a full month's pension) and changed

the method of indexation from Swiss-style indexation (50 percent indexation by price and 50 percent by wage growth) to indexation primarily by prices, effective January 2010.

**Poland.** A 2009 law eliminated early retirement under the old PAYG system and replaced it with temporary benefits (so-called "bridge pensions") for a very limited number of high-risk occupations. Bridge pensions are paid for 5 years—until age 60 for women and age 65 for men—to workers born before December 31, 1948, who meet certain qualifying conditions.

**Romania.** The government froze public pensions for 2011 and changed the method of indexation from 2012 onwards from wage-growth to Swiss-style indexation.

## *Discussion*

In short, the economic crisis spurred countries across CEE to reduce the fiscal burden of their pension systems through a variety of reforms. For countries that had adopted multipillar pension systems in the decade from 1998 to 2008, the most common approach was to divert second-pillar contributions back to the state-run PAYG programs, an approach that led to a weakening (or, in the case of Hungary, the elimination) of second-pillar programs across the region. While these measures were successful in reducing public debt and deficits in the short-term, it is unclear what the long-term impact will be on the adequacy of retirement benefits for future pensioners.

At the same time, the economic crisis has also led CEE countries to finally address the issue of population aging and its effect on long-term solvency of their public PAYG programs. As a result, a significant number of countries across the region have increased retirement ages and contribution requirements for a full pension, bringing them more in line with social security programs in Western Europe. This trend is likely to continue as countries take further steps to discourage early retirement. In Poland, for example, the government has proposed an increase in retirement ages from 65 for men and 60 for women to age 67 for men and women.

**Sources:** *International Update*, US Social Security Administration, various issues, 2008–2012; *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Romanian Parliament Adopts IMF-Backed Pension Law Raising Retirement Age," *Bloomberg*, December 7, 2010; "Romania Approves Pension Reform with Changes to Indexation, Retirement Age," *IPE.com*, December 17, 2010; "Lithuania Approves 2012 Budget with 3pct/GDP Gap," *Reuters*, December 20, 2011; "Poland Considers Raising Retirement Age to Save the Country," *Business Insider*, February 17, 2012.

# The Americas

## *Chile*

On January 30, the superintendent of pensions announced that Modelo was once again selected as the pension fund management company (AFP) to cover all new entrants to the labor force beginning in August. Modelo offered the lowest monthly administrative fee (32 percent lower than the current lowest fee) in the bidding process that began last November. As a result, an account holder who earns 500,000 pesos (US$1,050) a year and switches from the AFP with the current highest fee (2.36 percent of earnings) to the one with the lowest fee (0.77 percent of earnings as of August 2011) could save close to 100,000 pesos (US$210) a year.

The bidding process, a provision of the 2008 pension reform to improve competition among the AFPs and lower costs for account holders, is held every 24 months. The AFP selected must maintain the same fee (the winning bid) for 2 years for all of its account holders. New workers must remain with the winning AFP for 2 years unless (1) another AFP offers a lower fee for at least 2 consecutive months; (2) another AFP provides a higher rate of return sufficient to make up for a higher administrative fee; or (3) the winning AFP does not maintain the required minimum rate of return, is declared insolvent, or must liquidate its assets. Workers already in the system may switch to the winning AFP.

Modelo also won the first competition in 2010 when it was the first AFP to enter the pension market in 15 years. According to industry analysts, Modelo has been able to offer the lowest fee because it does not advertise or have a sales force; it has only the minimum required 15 branch offices, and it provides many services online. Despite having the lowest fee, at the end of the first year of operation, Modelo had only a 4.4 percent market share with 320,000 account holders, of which only 530 had transferred from another AFP (0.22 percent of all transfers in the system during the same period).

Workers contribute 10 percent of their taxable earnings, up to a maximum of approximately 1.5 million pesos (US$3,179) a month, to an individual account with the AFP of their choice. Currently, Chile has six AFPs, but a new one will begin operation later this year. At the end of January, total assets under management for all AFPs amounted to 72 trillion pesos

(US$151.2 billion); about 63 percent of investments were domestic (almost half were fixed income), and about 37 percent were foreign.

**Sources:** "Chile," *International Update*, US Social Security Administration, March 2010; "Seguimiento de la Reforma Previsional: Julio 2008–Junio 2011," Superintendencia de Pensiones, noviembre de 2011; "Ministro de Trabajo Afirma que con AFP Más Barata Puede Ahorrarse 100.000 Pesos," *Noticias Financieras,* el 30 de enero de 2012; Superintendencia de Pensiones Comunicado de Prensa, el 30 de enero de 2012; "Modelo Gana Segunda Licitación con Histórica Rebaja de Comisión," *Diario Financiero,* el 31 de enero de 2012; "Costos de AFP Participantes en Última Licitación Representan un 5.5% de la Industria," *Estrategia*, el 2 de febrero de 2012; "Valor y Rentabilidad de los Fondos de Pensiones: Enero de 2012," Superintendencia de Pensiones, el 7 de febrero de 2012.

## Asia and the Pacific

### *Singapore*

On February 17, the deputy prime minister presented Budget 2012 to Parliament for approval. The budget includes a measure to increase older workers' retirement savings by raising contribution rates to the Central Provident Fund (CPF) for workers aged 51 or older, effective September 2012. Budget 2012 would increase both the employer contribution rate (for workers aged 56–65) and the employee contribute rate (for workers aged 56–60); see the table below. To help make up for the higher employer cost, the budget contains another provision, the special employment credit, paid to employers who hire and retain older workers.

**Current and proposed CPF contribution rates as a percentage of wages, by age group**

| Age group | Current rates | | Proposed rates (September 2012) | |
|---|---|---|---|---|
| | Employer | Employee | Employer | Employee |
| 50 or younger | 16.0 | 20.0 | 16.0 | 20.0 |
| 51–55 | 12.0 | 18.0 | 14.0 | 18.5 |
| 56–60 | 9.0 | 12.5 | 10.5 | 13.0 |
| 61–65 | 6.5 | 7.5 | 7.0 | 7.5 |

SOURCES: "CPF Contribution and Allocation Rates from 1 September 2011," Central Provident Fund Board, September 27, 2011; "Budget 2012 Key Budget Initiatives, Measures for Households," Ministry of Finance, February 24, 2012.

Increasing employer/employee contribution rates would be the first step in the government's long-term goal to gradually raise the rates for workers aged 51–55 so that the rates for that group would eventually be the same as those for younger workers.

Since the 1980s, the government has lowered contribution rates for older workers twice to reduce employer costs of hiring higher-earning (typically older) workers and to make that group more attractive to employers. According to the government, the lower contribution rates did encourage increased hiring of older workers, and the number of older workers in the labor force is expected to continue growing. However, lower contribution rates have led to insufficient retirement funds for older workers, prompting the government's move to raise contribution rates in order to increase retirement savings for those workers.

The CPF is a publicly managed defined contribution system that is mandatory for most workers. Contributions are allocated into four separate individual accounts: (1) an ordinary account (OA), which can be used to finance the purchase of a home, approved investments, CPF insurance, and education; (2) a special account (SA), which is principally for old-age needs; (3) a medisave account, which pays for hospital treatment, medical benefits, and approved medical insurance; and (4) a retirement account (RA), which finances retirement. At age 55, CPF members must set aside a minimum of S$131,000 (US$105,017) from the OA and SA to fund the RA; any remaining funds may be withdrawn.

**Sources:** "Singapore," *International Update*, US Social Security Administration, June 2010; "How Much is the Minimum Sum?," Central Provident Fund Board, June 30, 2011; "CPF Contribution and Allocation Rates from 1 September 2011," Central Provident Fund Board, September 27, 2011; "Budget 2012 Theme: An Inclusive Society, A Stronger Singapore," February 17, 2012; "International Headlines," *Mercer*, February 23, 2012; "Budget 2012 Key Budget Initiatives, Measures for Households," Minister of Finance, February 24, 2012.

## Reports and Studies

### *European Commission*

On February 16, the European Commission (EC) released its *White Paper: An Agenda for Adequate, Safe and Sustainable Pensions*, which explores ways to support national pension reforms in the European Union (EU). It builds on stakeholder feedback on the *2010 Green Paper* regarding the same topic. The *White Paper* notes the urgency for developing and implementing comprehensive strategies for pension systems under challenging economic and demographic circumstances. According to the EC, the reform of pension systems and retirement practices are essential for improving Europe's growth prospects and urgently

required in some countries to restore confidence in government finances.

The *White Paper* outlines an agenda for creating the conditions for greater labor force participation of women and men, including older workers, and enhancing opportunities for retirement savings. The proposals (for discussion by the EU community in 2012–2013) include those that encourage member states to—

- Achieve a better balance between the time spent in work and in retirement, which may require making adjustments to pension systems, increasing retirement ages, and strengthening incentives to work longer.
- Develop complementary private retirement savings by encouraging social partners to develop supplementary (occupational and third pillar) plans and encouraging member states to promote such plans through optimal tax policies and other incentives.
- Enhance the safety of supplementary pension plans by ensuring effective protection of pension rights in the event of plan insolvency and improving consumer information and protection standards for retirement products.
- Make supplementary pensions compatible with job mobility through legislation protecting the pension rights of mobile workers and by promoting the establishment of pension tracking services across the EU.
- Encourage member states to promote longer working lives by linking retirement age with life expectancy, restricting access to early retirement, and closing the pension gap between men and women.

The document briefly reviews the *2010 Green Paper* consultation, including a summary of major points addressed in that process, key stakeholders' responses to specific questions about retirement age and the EU-level pensions framework (activities spanning policy coordination to regulation), and stakeholder responses to regulation-related questions. The *White Paper* concludes with a comprehensive inventory of pension-related recommendations for EU member states and lists national reform efforts, either pending or currently underway, with regard to pension systems.

**Sources:** *White Paper: An Agenda for Adequate, Safe and Sustainable Pensions*, European Commission, February 16, 2012; European Commission press release, February 16, 2012.

## *Social Security Administration*

The Social Security Administration has released *Social Security Programs Throughout the World: The Americas, 2011*—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: (1) old-age, disability, and survivors; (2) sickness and maternity; (3) work injury; (4) unemployment; and (5) family allowances. The other regional volumes in the series focus on the social security systems of countries in Africa, Asia and the Pacific, and Europe.

***International Update*** is a monthly publication of the Social Security Administration's (SSA's) Office of Retirement and Disability Policy. It reports on the latest developments in public and private pensions worldwide. The news summaries presented do not necessarily reflect the views of SSA.

Editor: Barbara E. Kritzer.

Writers/researchers: John Jankowski, Barbara E. Kritzer, and David Rajnes.

**Social Security Administration**
Office of Retirement and Disability Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor, Washington, DC 20254

SSA Publication No. 13-11712