Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

September 2013

This issue contains an occasional feature that provides a more in-depth look at recent changes to pension systems abroad. This month, the focus is on social pensions and subsidized benefits in Latin America.

Social Pensions and Subsidized Benefits in Latin America

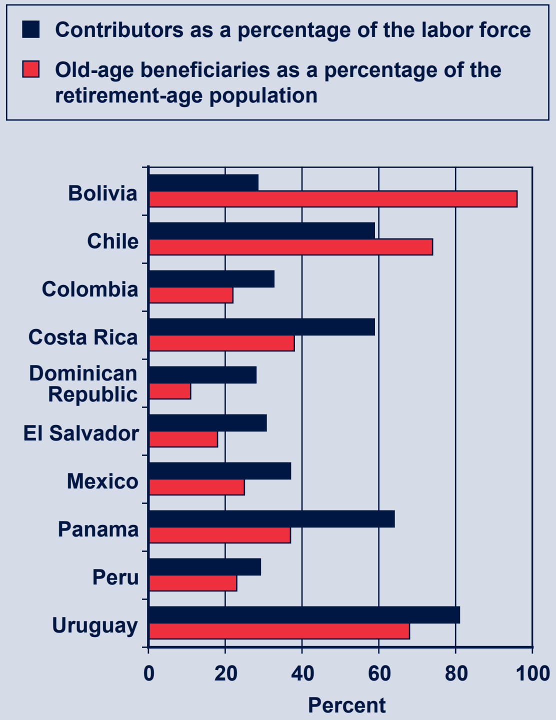
Improving pension coverage remains a major challenge for most of the Latin American countries, regardless of what type of pension program they have. One of the major reasons for the low rates of coverage in the region is the size of the informal labor force; in general, workers in the informal sector do not contribute to social security. In addition, workers who switch between the formal and the informal sectors may have some contributions, but not enough to qualify for a minimum benefit. Because of low rates of coverage, countries in the region have introduced social pensions for the most vulnerable groups of people who do not qualify for any other type of benefit and have added subsidies (often called guaranteed minimum benefits) for workers whose self-financed pension is below a certain threshold. This article focuses on the 10 Latin American countries with some form of individual account program: Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, El Salvador, Mexico, Panama, Peru, and Uruguay. Among the 10 countries—

- Bolivia, Chile, the Dominican Republic, El Salvador, and Mexico have first-pillar individual accounts;
- Colombia and Peru offer a choice between individual accounts and the public pay-as-you-go (PAYG) pension program;
- Costa Rica, Panama, and Uruguay have mixed systems—a first-pillar PAYG program and second-pillar individual accounts. In Panama and Uruguay, individual accounts are mandatory only for higher earners.

Coverage

Pension experts divide coverage into two phases: (1) the period of time an active worker contributes to a social security system and acquires the right to receive a benefit in the future and (2) the period of time that a retiree receives benefits. The accompanying chart presents data from the International Labour Office on the rates of coverage, both in terms of contributors as a percentage of the labor force and old-age beneficiaries as a percentage of the retirement-age population for the 10 Latin American countries in the 2009–2012 period. In the chart, the percentage of the labor force that is covered by social security includes workers that regularly contribute to either the individual account or the public program, depending on the type of system present in

Pension coverage in selected Latin American countries, 2009–2012



SOURCE: "El Rol de los Pisos de Protección Social en los Sistemas Integrales de Seguridad Social en América Latina y el Caribe (Documento Borrador para su Discusión)," Organización Internacional del Trabajo, Seminario Regional, el 26 y 27 de agosto de 2013.

the country. Note that the benefits for retirement-age adults are either contributory or noncontributory.

The labor force coverage rate ranges from 28 percent in the Dominican Republic to 81 percent in Uruguay, and the rate for the retirement-age population ranges from more than 10 percent in the Dominican Republic to about 96 percent in Bolivia. In addition, the difference between the two phases of coverage in each of the countries in the region with some form of individual account system is the largest in Bolivia and the smallest in Peru.

Noncontributory or Social Pensions

All 10 countries provide some type of noncontributory or social pension (the terms are often used interchangeably) to needy adults who do not qualify for any other type of retirement benefit (Table 1). All of the noncontributory programs provide old-age benefits, of which three provide old-age and disability benefits (Chile, Costa Rica, and Uruguay), and one (El Salvador) provides old-age, disability, and survivors benefits. The Dominican Republic will also offer all three types of benefits when the program is

Table 1.
Characteristics of noncontributory (or social pension) programs in selected Latin American countries

Country (year started) [a]	Name of program (Spanish/English)	Age of eligibility	Source of funding			
			General revenue	Earmarked taxes	Separate fund	Other
Bolivia (1996, 2008)	Renta Dignidad/Dignified Income	60	X	X	X	X
Chile (1991, 2008)	Pensiones Solidarias/Solidarity Pensions	65			X	X
Colombia (2003)	Colombia Mayor/Older Colombia	57 (men), 52 (women) [b]	X		X	
Costa Rica (1974)	Regimen No Contributivo de Pensiones por Monto Basico (RNC)/ Noncontributory pension scheme with a basic amount	65	X	X		X
Dominican Republic [c]	Pension Solidaria/Solidarity Pension	60	X			X
El Salvador (2009)	Programa de Pensiones Asistenciales/Social assistance pensions	70	X			
Mexico (2007, 2013)	65 y Mas/65 and Older	65	X			
Panama (2009)	100 a los 70/100 for the 70 year olds	70	X			
Peru (2011)	Pension 65/Pensions for the 65 year olds	65	X			
Uruguay (1919, 1995)	Programa de Pensiones Noncontributivas a la Vejez e Invalidez (PNC)/Noncontributory old-age and disability pension program	70	X			

SOURCES: "Programas de Pensiones No Contributivas en Países FIAP, Parte 1: América Latina," FIAP, mayo 2011; "Pension Watch," HelpAge International Social Protection Database, September 17, 2012; "Pensiones No Contributivas en América Latina,"Transferencias Sociales, Banco Interamericano de Desarrollo, 2013; "El Rol de los Pisos de Protección Social en los Sistemas Integrales de Seguridad Social en América Latina y el Caribe (Documento Borrador para su Discusión)," Organización Internacional del Trabajo, Seminario Regional, el 26 y 27 de agosto de 2013.

a. When there are 2 years listed, the current program replaced another similar one.

b. The age of eligibility is rising to 62 (men) and 57 (women) in 2014.

c. Not yet implemented. The regulations were approved In July 2013.

implemented; the regulations for those benefits were approved in July 2013. Recently, the Mexican president introduced a pension reform bill to Congress that would set up a universal noncontributory old-age benefit.

Currently, Bolivia has the only universal social pension among the countries under study: The full benefit is paid to workers without any other type of pension, while pensioners receive 75 percent of the full benefit. The noncontributory pensions in the other countries with individual accounts target the neediest adults. However, in El Salvador and Colombia, the programs are gradually being extended by geographic area; the poorest regions or urban areas are covered first. Funding in most of these countries is from general revenues. Funding also may come from earmarked taxes (Bolivia and Costa Rica) and a separate fund (Bolivia, Chile, and Colombia).

Subsidized Pension Benefits

Subsidized benefits are paid to workers who have made some contributions to an individual account, but not enough to qualify for a minimum benefit. Table 2 describes characteristics of the subsidy programs in the countries under study. Four countries are excluded: those with mixed systems (Costa Rica, Panama, and Uruguay) do not provide this type of subsidy, and Peru's guaranteed minimum pension is only for retirees born before January 1, 1946.

Other subsidy programs that have been enacted into law, but have not yet been implemented include the following:

- the subsidized contributory old-age, disability, and survivors program for the self-employed (part of the 2001 law that introduced individual accounts) in the Dominican Republic; and
- special subsidized programs for certain categories of low-income workers in Colombia.

This top-up subsidy is paid on a sliding scale; eligible workers with the lowest pension entitlement receive the highest amount, and those with the highest pension entitlement receive the lowest amount. The characteristics of the subsidies that are similar in some countries and differ in others include the following:

- In many countries, the minimum benefit is equal to the minimum wage.
- Workers must be at or close to the normal retirement age and, except for in Chile, have a minimum number of contributions.
- Chile and Colombia have a residency requirement.
- Bolivia and Mexico only provide old-age subsidies.

Both Colombia and Mexico also have subsidies to supplement the contributions paid by low-income workers for old-age protection.

Table 2.
Subsidized benefits in selected Latin American countries

Type of benefit	Qualifying conditions				Financing
	Age of eligibility	Contributions	Benefit or earnings level	Other	
Bolivia					
Old-age top up	58 (lower ages for women with children, miners, and workers in metallurgical industries)	10 years	Minimum and maximum thresholds vary according to number of years of contributions (from 10 to 35); benefit increases with more years of contributions	NA	Insured person and employer contributions; higher earners pay a higher percentage of earnings
Chile					
Old-age top up	65 (men), 60 (women)	NA	Self-financed pension below threshold set by the government; family among poorest 60 percent of population	Resident for 20 years including 4 of last 5 years	Government
Disability top up	18 to 64	NA	Self-financed pension below threshold set by the government; family among poorest 60 percent of population	Assessed as disabled; resident for 5 of last 6 years	Government

Continued

Table 2.
Subsidized benefits in selected Latin American countries—*Continued*

Type of benefit	Qualifying conditions: Age of eligibility	Qualifying conditions: Contributions	Qualifying conditions: Benefit or earnings level	Qualifying conditions: Other	Financing
Colombia					
Old-age top up	62 (men), 57 (women)	1,275 weeks (rising to 1,325 by 2015)	Self-financed pension below minimum pension	Resident for past 10 years	Higher-earner contributions
Old-age contribution subsidy (paid for 500 to 750 weeks)	Formal-sector workers, 58; informal-sector workers, 35 (men) and 30 (women)—both up to 65	500 weeks (have to contribute between 5 percent and 30 percent of full contribution)	Earns below minimum wage	NA	Higher-earner contributions; certain fines paid by pension fund management companies and employers
Disability top up	20 up to 65	26 weeks before disability began	Self-financed pension below minimum wage	Assessed as disabled	Insurance premiums paid by account holders
Survivors top up	Insured was an old-age or disability pensioner at time of death	26 weeks immediately before or in the year before death	Pension below minimum wage	Beneficiary must be a member of deceased's family	Insurance premiums paid by account holders
Dominican Republic					
Old-age top up	Older than 65	300 months	Low income; pension below minimum pension	NA	Employer contributions
El Salvador					
Old-age top up	60 (men), 55 (women)	25 years	Income, including pension, below minimum wage	NA	Government
Disability top up	NA	10 years or 3 of last 5 years of contributions before disability began; for nonwork-related accident, 6 of last 12 months before accident	Income, including pension, below minimum wage	Assessed as disabled	Government
Survivors top up	NA	10 years before insured's death or 3 of last 5 years before insured's death; for an accident, 6 of last 12 months before insured's death, who was contributing at time of death	Income, including survivor pension, below minimum wage		Government
Mexico					
Old-age top up	65	1,250 weeks or 24 years	Self-financed pension below minimum wage (in Mexico City)	NA	Government
Old-age contribution subsidy (a flat-rate that varies according to salary)	NA	Government subsidy paid only when account holder makes contributions	NA	NA	Government

SOURCES: *Programas de Pensiones No Contributivas en Paises FIAP, Parte 1: América Latina,* FIAP, mayo 2011; *Social Security Programs Throughout the World: The Americas, 2011,* US Social Security Administration, 2012.

Discussion

Introducing individual accounts (funded old-age savings) in Latin American pension systems did not accomplish one of its major goals—closing the pension coverage gap. Even though guaranteed minimum benefits were usually a part of the reform, a large proportion of contributors do not or will not have enough contributions to qualify for the minimum pension based on their contribution patterns. To address this problem, many of these countries introduced noncontributory pensions and subsidized benefits to provide protection to those workers. To date, the success of these programs is mixed. For example, because Bolivia's program is universal, coverage is very high. Also, Chile has reached its goal of providing these benefits to the poorest 60 percent of the population. Thus, for most of the countries under study, one of the greatest challenges for the future will remain how to extend coverage successfully to a larger portion of the retirement-age population.

Sources: "Ampliando la Proteccion: El Papel de Las Pensiones Minimas y de La Asistencia Social," Organización Internacional del Trabajo, 2002; *La Cobertura de los Sistemas Previsionales en América Latina: Conceptos e Indicadores*, World Bank, 2011; *International Update* (various issues), US Social Security Administration, 2011 through 2013; "Programas de Pensiones No Contributivas en Países FIAP, Parte 1: América Latina," FIAP, mayo 2011; *Social Security Programs Throughout the World: The Americas, 2011,* US Social Security Administration, 2012; "Pension Watch," HelpAge International Social Protection Database, September 17, 2012; "Colombia Mayor," Colombia Mayor Consorcio, 2013; "Programa 100 a los 70," Proyecto Cohesíon Social, Panama, Ministerio de Desarrollo Social, 2013; "Pensiones No Contributivas en América Latina," Transferencias Sociales, Banco Interamericano de Desarrollo, 2013; "El Rol de los Pisos de Protección Social en los Sistemas Integrales de Seguridad Social en América Latina y el Caribe (Documento Borrador para su Discusión)," Organización Internacional del Trabajo, Seminario Regional, el 26 y 27 de agosto de 2013; "Mexico: President Outlines Social Security Reform," Mercer *International Headlines,* September 18, 2013.

Asia and the Pacific

Malaysia

In August, the Employees Provident Fund (EPF) announced changes designed to help the workforce save more for retirement and prevent old-age poverty in future decades. The government has indicated that ensuring adequate retirement savings is becoming a major concern as the population rapidly ages. According to government projections, by 2030, the share of the population aged 60 or older will more than double from the current 7 percent to 15 percent, and life expectancy will increase from 72.6 years (men) and 77.5 years (women) to 74.2 years and 79.1 years, respectively.

Effective August 5, the age limit for mandatory employer and employee contributions to the EPF increased from age 55 to 60. This measure follows the July 1 increase in the minimum retirement age for private-sector workers from age 55 to 60. (Previously, there was no statutory retirement age, although a retirement age of 55 was the norm.) The government anticipates that more than 6 million EPF active members could benefit from the higher savings level.

Another measure to help raise the level of retirement savings will take effect on January 1, 2014. The basic savings amount Malaysians must accumulate in their retirement account by age 55 will rise from 120,000 ringgits (US$36,527) to 196,800 ringgits (US$59,803). The basic amount increases with age, starting at 1,000 ringgits (US$304) at age 18 and aims to provide a retirement benefit of 820 ringgits (US$250) a month (the current minimum pension for public employees), for 20 years from ages 55 to 75. The EPF divides total contributions into two types of accounts: 70 percent is directed to Account 1 for retirement (a portion can be drawn down periodically to purchase approved investments before retirement); and 30 percent is directed to Account 2, which can be drawn down before retirement for the purchase of a house, for education costs, and certain health-related expenses. At retirement, funds can be withdrawn from both accounts as a lump sum payment, periodic payment, or a combination of the two. While the EPF guarantees a minimum return of 2.5 percent per year, annual dividends on fund assets (totaling 536 billion ringgits (US$163 billion) at the end of March 2013) have been at least 4.5 percent over the past decade.

Malaysia's public pension system includes the mandatory EPF for private-sector employees and certain public-sector workers not covered by the separate public-sector system. It provides lump-sum old-age, survivors, and disability benefits for its 13.7 million members (of which 6.4 million are active contributors). Employers contribute 12 to 13 percent of employees' monthly salaries (13 percent for monthly salaries of 5,000 ringgits (US$1,519) or less and 12 percent for employees earning above that amount), while employees must contribute 11 percent of their monthly salaries until age 60. As an incentive to keep older workers in the labor force, contributions for employees aged 60 or older are reduced by 50 percent for both workers and employers. People who continue working after age 60 must contribute to an EPF account until they retire or reach age 75, whichever comes first.

Sources: *Employee Benefits Reference Manual 2013—Malaysia*, Swiss Life Network, 2013; "Few Embrace Malaysia Retirement Plan," *The Wall Street Journal Asia Edition*, July 25, 2013; "New EPF Rates for All," *The Sun Daily*, August 7, 2013; "EPF Basic Savings Revised to Avoid Old-age Poverty," *The Malaysian Reserve*, August 23, 2013; "Malaysia's EPF Announces Steps to Boost Retirement Savings," *Pensions & Investments*, August 23, 2013; "Overview of the EPF," Employees Provident Fund, August 29, 2013; "EPF to Raise Members' Basic Savings Level," *Business Times*, September 13, 2013.

Africa

South Africa

On July 11, the National Treasury of South Africa released "Charges in South African Retirement Funds," the last in a series of discussion papers on promoting household savings and improving the retirement savings industry in the country. The paper analyzes the current level of management costs and administrative fees, compares them with those of other countries, and examines the causes of the relatively high observed costs and fees in South Africa. The paper is now subject to public consultation until September 30, and the government plans to present draft pension legislation incorporating proposals from all five discussion papers to Parliament in 2014.

Among the paper's main findings is that structural factors—such as a large number of retirement funds (approximately 3,000 active funds at present), the voluntary nature of the system, and low account balances—are significant drivers of the costs of the country's retirement system, which are found to be high compared with those of other countries. In order to reduce costs and fees in the retirement industry, the paper discusses various reform options that include—

- encouraging fund consolidation by moving toward multiemployer arrangements;
- improving fund governance;
- strengthening fund regulation;
- simplifying plan design, making enrollment into retirement funds mandatory; and
- establishing a default fund for employers who do not select a fund themselves.

The previous four discussion papers, each of which focused on a separate issue relating to retirement in the country, include the following:

- "Enabling a Better Income in Retirement," which reviews the current market of retirement income products in South Africa and proposes measures to ensure that low-cost and easily accessible products are available to workers at retirement.
- "Preservation, Portability and Governance for Retirement Funds," which discusses the low rate of preservation of retirement savings (pre- and postretirement) and proposes various measures to improve it. The paper also discusses the portability of retirement savings and the government's attempts to improve the governance of pension funds.
- "Incentivising Nonretirement Savings," which proposes tax-deferred individual savings and investment accounts as a way to improve short- and medium-term savings in the country, reduce dependency on credit, and encourage savings in lower-income households.
- "Improving the Tax Incentives of Retirement Savings," which proposes harmonizing the tax treatment of contributions such that all contributions to retirement funds—including annuities, pension, and provident funds—and all benefits from those funds receive the same tax treatment.

According to the government, the current retirement system (occupational pensions) in South Africa favors employed higher earners. However, even though South Africa has the most developed private pension system in the region, more than half of the formal labor force is not covered; the level of coverage depends on the industry and the trade union. The country has no earnings-related public pension system; it only provides a means-tested, old-age pension of up to 1,200 rand (US$116) a month to workers aged 60 or older.

Sources: "South Africa," *International Update*, US Social Security Administration, June 2012; "Enabling a Better Income in Retirement" and "Preservation, Portability and Governance for Retirement Funds," National Treasury, September 21, 2012; "Incentivising Nonretirement Savings" and "Improving Tax Incentives for Retirement Savings," National Treasury, October 4, 2012; "Charges in South African Retirement Funds," National Treasury, July 11, 2013; National Treasury press release, July 11, 2013.

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