International Update

Recent Developments in Foreign Public and Private Pensions

December 2017

Europe

Romania Changes Social Security Contribution Rates

On November 9, the Romanian government passed a new tax law that substantially decreases the employer social security contribution rate and substantially increases the employee contribution rate. (Social security contributions finance old-age, disability, and survivors insurance [OADSI]; sickness and maternity benefits; work injury benefits; unemployment benefits; and health insurance.) In addition, the new law reduces the portion of employee contributions diverted to second-pillar mandatory individual accounts and increases the share transferred to the first-pillar public pension program. The measures are effective January 1. To help offset the increase in the employee contribution rate, the law reduces the current personal income tax rate from 16 percent of earnings to 10 percent. The government also anticipates that the reduced employer contribution rate will lead to an increase in private-sector wages. (A previously approved measure increases public-sector wages by 25 percent in 2018.)

Key measures of the new law include:

- A reduction in the combined employer/employee social security contribution rate by 2 percentage points, from 39.25 percent of earnings to 37.25 percent.
- A substantial reduction in the employer social security contribution rate from 22.75 percent of earnings to 2.25 percent, and a substantial increase in the employee contribution rate from 16.5 percent of earnings to 35 percent. Under the new law, employer contributions finance sickness and maternity benefits, work injury benefits, and unemployment benefits, while employee contributions finance OADSI pensions (including the mandatory individual account) and health insurance.
- A reduction in the portion of employee contributions diverted to second-pillar mandatory individual accounts from 5.1 percent of earnings to 3.75 percent. (Employers do not contribute to individual accounts on behalf of their employees.) When the individual account program was implemented, the contribution rate was scheduled to gradually increase from 2 percent of earnings in 2008 to 6 percent of earnings in 2016 (with a corresponding reduction in contributions diverted to the first-pillar program); however, budgetary pressures led the government to postpone these increases in recent years.

Romania's old-age pension system consists of a first-pillar social insurance program and a second pillar of mandatory individual accounts. The first-pillar program covers employed persons with individual labor contracts, civil servants, self-employed persons with monthly average net income of at least 938 lei (US$240.75), and certain other workers, while the mandatory individual account program covers all employed and self-employed persons younger than age 36 on January 1, 2008. (Voluntary coverage is possible for those aged 36 to 45 on January 1, 2008.) The normal retirement age under both programs is 65 (men) or 60 and 3 months (women, gradually rising to age 63 by 2030) with at least 15 years of contributions. The full pension is paid with at least 35 years (men) or 30 years and 3 months (women, gradually rising to 35 years by 2030) of contributions.

Sources: *Social Security Programs Throughout the World: Europe, 2016*, U.S. Social Security Administration, September 2016; "CEE Roundup: Romania Slashes Second-Pillar Contributions," IPE.com, November 10, 2017; "Romania: Reducing the Contribution for Second Pension Pillar Will Lead to a Significant Decrease of the Pension's Value for a High Number of Participants – AURSF," 1asig.ro, November 10, 2017; "Romania – Significant Changes Proposed to Tax and Social Security Legislation," KPMG, November 27, 2017; "Romania: Government Shifts Social Security Funding to Employees," *Global News Briefs*, Willis Towers Watson, December 1, 2017; "Romania Government Okays 2018 Budget with Deficit Just Below EU Limit," *Reuters News*, December 6, 2017.

International

Organisation for Economic Co-operation and Development Releases Report on Aging and Inequality

On October 18, the Organisation for Economic Co-operation and Development (OECD) released *Preventing Aging Unequally*, a report examining the interactive effects of population aging and rising inequalities on the well-being of older persons in the 35 OECD member countries and several emerging economies. Drawing on a wide range of cross-country economic and social data, the report shows that disadvantages in education, health, employment, and earnings reinforce each other and compound as people age, resulting in large socioeconomic disparities at older ages. Although the report finds that the current generation of older people is generally better off than previous generations, it predicts that the coming generations of older people will experience greater inequalities and poverty. The report emphasizes that these "aging unequally" trends will negatively affect future economic growth, particularly as they reduce social mobility and erode social cohesion. To counter the effects of aging unequally, the report highlights best practices in an array of policy areas, including education, health care, employment support, family leave, old-age and survivor pensions, and long-term care.

To better understand how population aging and rising inequalities have been developing and interacting, the report analyzes these two mega-trends from several different perspectives. In its analysis of global demographic data, the report shows that socioeconomic factors have a larger impact on longevity than previously thought. For instance, when it looks at life expectancy at age 25 for different education subgroups, the report finds that college-educated men in OECD countries can expect, on average, to live 7.5 years longer than their low-educated peers; for women, the difference is lower at 4.6 years. Using harmonized income data, the report also points out that income inequality at the same ages has increased across birth cohorts since the 1920s in 21 of the 26 OECD countries analyzed. Several other notable findings from the report include:

- Unhealthy individuals work and earn significantly less than their healthier peers throughout their lifetimes. Being in poor health is associated with a 33 percent loss in lifetime earnings for low-educated men and a 17 percent loss for college-educated men compared to healthy men with the same levels of education; the respective figures for women are lower at 18 percent and 13 percent.
- Higher wage inequality translates into higher pension inequality in most OECD countries because pension benefits are strongly linked to lifetime contributions. On average, a percentage point increase in lifetime earnings inequality (as measured by the Gini coefficient) results in a 0.68 percentage point increase in pension inequality (also measured by the Gini coefficient). (The Gini coefficient is a measure of income inequality that varies from 0 percent [everyone has the same income] to 100 percent [one person has all of the income while everyone else has none].)
- Older women continue to receive smaller pension benefits and experience higher rates of poverty than their male peers even though the gender employment gap has narrowed in most OECD countries. In 2014, the average annual pension income for women aged 65 or older in 28 OECD countries was 27 percent lower than for men in the same age group.

To prevent, mitigate, and cope with the effects of aging inequality, the report offers a broad range of policy recommendations, including some pertaining to old-age pensions such as:

- Incorporating mechanisms into public pension systems and private annuity products that compensate for socioeconomic differences in life expectancy. These mechanisms could include actuarial rates and contribution rates that vary according to income and modifiers that adjust benefits based on certain health or behavioral factors.
- Focusing on improving mandatory pensions rather than subsidizing voluntary pensions when pension adequacy is an issue. Public financing of voluntary pensions through tax incentives and other measures should be limited because these benefits tend to be regressive and thus contribute to old-age income inequality.
- Increasing pension coverage for workers who are self-employed or engaged in nonstandard work. Although most OECD countries already have high levels of coverage, changing work patterns are eroding coverage because existing pension systems typically do not cover all types of work contracts, have limited portability, or have inflexible qualifying conditions.

Source: *Preventing Aging Unequally*, Organisation for Economic Co-operation and Development, October 18, 2017.

Organisation for Economic Co-operation and Development Releases Pensions at a Glance 2017

On December 5, the Organisation for Economic Co-operation and Development (OECD) released *Pensions at a Glance 2017*, its biennial report that examines public and private pension systems in the 35 OECD member countries and other G20 countries. The report highlights recent pension reforms, presents statistics on a wide range of pension-related indicators, and provides detailed summaries of the pension systems of the countries surveyed. In addition, this year's edition provides an in-depth analysis of flexible retirement options in OECD countries, including their usage and effect on benefit levels.

According to the report, the pace of pension reforms across the OECD has slowed and become less widespread in the past two years, largely because of improved public finances. However, countries have continued to adopt pension reforms, including changes to contribution rates (12 countries), benefit levels (12 countries), pension-related tax incentives (seven countries), and normal retirement ages (six countries). Based on current legislation, the normal retirement age will increase in roughly half of OECD countries—by 1.5 years for men and 2.1 years for women on average—reaching an average of just under age 66 by 2060. The report notes that three countries (Denmark, Italy, and the Netherlands) have future normal retirement ages above 68, while only five countries (France, Greece, Luxembourg, Slovenia, and Turkey) will have a normal retirement age below 65.

The report includes a special focus on flexible retirement—the ability to receive a full or partial pension while continuing to work—in OECD countries. According to the report, many workers desire to combine pensions and work, but relatively few are participating in flexible retirement arrangements; in Europe, for example, only around 10 percent of individuals aged 60 to 69 currently combine work and pensions. In the countries that allow for combining work and pensions past the normal retirement age, many have disincentives such as earnings limits beyond which pension benefits are reduced. The report highlights Chile, the Czech Republic, Estonia, Italy, Mexico, Norway, Portugal, the Slovak Republic, and Sweden as countries offering flexible retirement options that have no earnings limits, reward postponing retirement (through higher pension amounts), and do not heavily penalize early retirement. The report recommends that other countries improve their flexible retirement options conditional on ensuring (through actuarial adjustments) the financial balance of their pension systems. At the same time, countries must also ensure that the early retirement age is set high enough to ensure adequate pensions.

The report also examines pension system design, pension entitlements, pension-related demographic and economic trends, elderly income and poverty levels, pension system finances, and pension reserve funds. Notable findings from these chapters include:

- Future gross replacement rates (the ratios of pension income to lifetime average earnings for average-wage workers) will average 53 percent (men) or 52 percent (women) in the OECD countries, ranging from a low of 22 percent in the United Kingdom to a high of 97 percent in the Netherlands. Net replacement rates, which reflect income after taxes, will range from less than 30 percent in Mexico and the United Kingdom to more than 100 percent in the Netherlands and Turkey.
- The total fertility rate (TFR, the expected number of births per women based on current birth rates) in 2015 was below the replacement level of 2.1 in all OECD countries except Israel (2.93) and Mexico (2.14). However, there has been a slight average increase in TFRs across the OECD countries since 2000.
- Life expectancy at age 65 is forecast to increase on average by 4.6 years (men) or 4.2 years (women) over the next 45 years. Similarly, the average old-age dependency ratio—the number of individuals aged 65 or older for every 100 persons aged 20 to 64—is expected to roughly double from the current 28 to 58 by 2075.
- Relative income poverty (defined as having less than 50 percent of median household income) is higher for individuals aged 65 or older in OECD countries than the general population (on average, 12.5 percent and 11.5 percent, respectively).
- The average contribution rate for an average-wage worker was 18.4 percent of covered earnings in 2016 for the 22 OECD countries with pension-specific rates, while the combined (employee and employer) social insurance and mandatory private pension contributions for another 12 countries averaged 22.9 percent of covered earnings.
- Public pension expenditures increased by about 1.5 percent of gross domestic product (GDP) from

2000 to 2013 (from 6.7 percent to 8.2 percent), but the rate of spending growth is projected to decline. Long-term projections show that public pension expenditures will grow in 21 OECD countries and decline in 14 countries.

- Mandatory or quasi-mandatory private pension systems with universal or near universal coverage operate in 17 OECD countries; 10 other countries have voluntary occupational or personal private pensions that cover more than 40 percent of the working-age population.
- Private pension assets on average in 2016 were 83 percent of GDP in OECD countries. In the 18 OECD countries with public pension reserves, the average size of public pension assets was 19 percent of GDP.

Source: *Pensions at a Glance 2017: OECD and G20 Indicators*, Organisation for Economic Co-operation and Development, December 5, 2017.

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